

TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1921.

No. 535.

JOHN D. ROCKEFELLER, PLAINTIFF IN ERROR,

vs.

THE UNITED STATES OF AMERICA.

**IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR
THE SOUTHERN DISTRICT OF NEW YORK.**

FILED SEPTEMBER 15, 1921.

(28,490)



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United States District Court for the Southern District of New York.

L 24-77.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

To the above-named defendant :

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service; and in case of your failure to appear, or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness the Honorable Learned Hand, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, this 20th day of December, in the year one thousand nine hundred and twenty.

[SEAL.]

ALEX. GILCHRIST, JR.,
Clerk.

FRANCIS G. CAFFEY,
*United States Attorney,
Plaintiff's Attorney.*

Office and Post Office Address, U. S. Court and P. O. Building,
Borough of Manhattan, New York City.

United States District Court, Southern District of New York,

L 24-77.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

Notice of Appearance.

SIR:

Please take Notice, That the Defendant John D. Rockefeller hereby appears in the above entitled action, and that we are retained Attorneys for him therein, and hereby demand that a copy of the

complaint and of all other papers in this action be served on us at our office below designated.

Dated January 5th, 1921.

Yours, &c.,

MURRAY, PRENTICE & ALDRICH,
Attorneys for Defendant.

Office and Post Office Address, 37 Wall Street, New York City.

To Francis G. Caffey,
Attorney for Plaintiff.

3 [Endorsed:] United States District Court, Southern District of New York. United States of America, Plaintiff, against John D. Rockefeller, Defendant. Notice of Appearance of Defendant John D. Rockefeller. Murray, Prentice & Aldrich, Attorneys for Defendant. Received Jan. 6, 1921. U. S. Attorney's Office. #23153. A. C. Entered.

4 United States District Court, Southern District of New York

L. 24-77.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

Complaint.

Taxes, Interest, and Penalty under the Act of October 3, 1913.

Francis G. Caffey, United States Attorney for the Southern District of New York, Attorney for Plaintiff.

Office and Post Office Address: U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

5 United States District Court, Southern District of New York

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

Complaint.

Taxes, Interest, and Penalty under the Act of October 3, 1913.

Plaintiff above-named by Francis G. Caffey, United States Attorney for the Southern District of New York, its attorney, complaining of the defendant, alleges upon information and belief:

First. That at all the times hereinafter mentioned plaintiff was and now is a corporation sovereign.

Second. That at all the times hereinafter mentioned defendant was and now is a resident and inhabitant of the Southern District of New York.

Third. That during the calendar year ending December 31, 1915, defendant was the owner and holder of one hundred fifty thousand, three hundred thirteen (150,313) shares of the capital stock of a certain corporation known as The Ohio Oil Company, and on or about the 4th day of February, 1915, said corporation, The Ohio Oil Company, paid to defendant and defendant received a dividend upon said shares of stock held by him in said The Ohio Oil Company; that said dividend consisted of fifty thousand one hundred four and 983383/2950149 (50,104 983383/2950149) shares of the capital stock of a certain other corporation known as The Illinois Pipe Line Company of the par value of One hundred Dollars (\$100.) each.

Fourth. That during the calendar year ending December 31, 1915, defendant was the owner and holder of forty-four thousand, seven hundred eighty-four (44,784) shares of the capital stock of a certain corporation known as The Prairie Oil & Gas Company, and on or about the 25th day of March, 1915, said corporation, The Prairie Oil & Gas Company, paid to defendant and defendant received a dividend on said shares of stock held by him in said The Prairie Oil & Gas Company; that said dividend consisted of sixty-seven thousand one hundred seventy-six (67,176) shares of the capital stock of a certain other corporation known as The Prairie Pipe Line Company, of the par value of One hundred Dollars (\$100.) each.

Fifth. That the par value of said 50,104 983383/2950149 shares of the capital stock of The Illinois Pipe Line Company, received by defendant as aforesaid, was Five million ten thousand four hundred thirty-three and 34/100 Dollars (\$5,010,433.34); that the par value of said 67,176 shares of the capital stock of The Prairie Pipe Line Company received by defendant as aforesaid was Six million seven hundred seventeen thousand six hundred Dollars (\$6,717,600.00), in all the sum of Eleven million seven hundred twenty-eight thousand thirty-three and 34/100 Dollars (\$11,728,033.34).

Sixth. That the market value of said 50,104 983383/2950149 shares of the capital stock of The Illinois Pipe Line Company at the time the same were distributed to defendant by The Ohio Oil Company, and received by him as hereinabove set forth, was Six million six hundred sixty-three thousand nine hundred sixty-five Dollars (\$6,663,965.00); that the market value of said 67,176 shares of the capital stock of The Prairie Pipe Line Company at the time the same were distributed to defendant by said The Prairie Oil & Gas Company and received by him as hereinabove set forth, was Nine million nine hundred forty-two thousand

forty-eight Dollars (\$9,942,048.00), in all the sum of Sixteen million six hundred six thousand thirteen Dollars (\$16,606,013.00).

Seventh. That pursuant to the requirements of the Act of Congress approved October 3, 1913, defendant on or about the 28th day of March, 1916, filed with the Collector of Internal Revenue for the Third District of New York a return purporting to be a true and complete statement of the gains, profits and income received by or accrued to defendant during the calendar year ending December 31, 1915.

Eighth. That said return was incorrect, misleading and false in that, among other items, defendant failed to include therein as part of the gains, profits and income received by or accrued to him during said calendar year any part of said 50,104 983383/2950149 shares of the capital stock of The Illinois Pipe Line Company or any part of said 67,176 shares of the capital stock of The Prairie Pipe Line Company, or the value of said shares, or of any part thereof.

8 Ninth. That thereafter defendant's said return was audited by the Commissioner of Internal Revenue and was corrected by said Commissioner of Internal Revenue by including therein as part of the gains, profits and income received by defendant during said calendar year ending December 31, 1915, together with other items, the par value of all of said shares of stock of The Illinois Pipe Line Company and of The Prairie Pipe Line Company, received by defendant as above set forth, namely, the sum of Eleven million seven hundred twenty-eight thousand thirty-three and 34/100 Dollars (\$11,728,033.34); that on or about the 9th day of July, 1917, said Commissioner of Internal Revenue assessed against defendant an additional tax in the sum of Seven hundred fifty-four thousand seven hundred thirty-seven and 9/100 Dollars (\$754,737.09) of which additional tax the sum of Seven hundred three thousand six hundred eighty-two Dollars (\$703,682.) was assessed upon the par value of said shares of stock.

Tenth. That said additional tax in the sum of Seven hundred fifty-four thousand seven hundred thirty-seven and 9/100 Dollars (\$754,737.09) assessed against defendant as aforesaid was paid by said defendant to the Collector of Internal Revenue for the Third District of New York on or about the 24th day of September, 1917.

Eleventh. That the net income of said defendant for said calendar year ending December 31, 1915, irrespective of said shares of stock received by defendant as dividends as above set forth, was in excess of the sum of Five hundred thousand Dollars (\$500,000.)

9 and by reason of the premises an additional tax in the sum of Two hundred ninety-two thousand six hundred seventy-eight and 78/100 Dollars (\$292,678.78) became due and owing from the defendant to the plaintiff, namely, an additional tax of six per cent on the sum of Four million eight hundred seventy-seven thousand nine hundred seventy-nine and 66/100 Dollars

(\$4,877,979.66) the difference between the market value of said shares of stock at the time the same were distributed to and received by defendant, to wit, Sixteen million, six hundred six thousand thirteen Dollars (\$16,606,013.00) and the par value of said shares of stock, to wit, Eleven million seven hundred twenty-eight thousand thirty-three and 34/100 Dollars (\$11,728,033.34), upon which the tax has been paid as above set forth.

Twelfth. That no part of said additional tax of Two hundred ninety-two thousand six hundred seventy-eight and 78/100 Dollars (\$292,678.78) has been paid, although duly demanded, and the same is now due and owing from said defendant to plaintiff together with a penalty of Five per cent (5%) of the amount thereof and interest on the same at the rate of one per cent (1%) per month from the 30th day of June, 1916.

Thirteenth. That the Commissioner of Internal Revenue authorizes and sanctions these proceedings.

Wherefore plaintiff demands judgment against defendant for the sum of Two hundred ninety-two thousand six hundred seventy-eight and 78/100 Dollars (\$292,678.78) together with a penalty of Five per cent (5%) of said sum, and interest thereon at the rate of one per cent (1%) per month from the 30th day of June, 1916, and for the costs and disbursements of this action.

FRANCIS G. CAFFEY,
*United States Attorney for the
Southern District of New York,
Attorney for the Plaintiff.*

Office and Post Office Address: U. S. Courts and P. O. Bldg.,
Borough of Manhattan, City of New York.

UNITED STATES OF AMERICA,
*State of New York,
Southern District of New York, ss:*

Richard S. Holmes, being duly sworn, deposes and says that he is a Special Assistant to the United States Attorney for the Southern District of New York, and, as such, has charge of the above-entitled action; that he has read the foregoing complaint and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated to be alleged upon information and belief and that as to those matters he believes it to be true.

That the reason this verification is made by deponent and not by plaintiff is that plaintiff is a corporation sovereign.

That the sources of deponent's knowledge and the grounds of his belief as to all matters stated in said complaint to be alleged upon information and belief, are certified photostat copies of the tax return and claim for refund heretofore filed by defendant herein,

11 correspondence had with the Commissioner of Internal Revenue and copies of reports of agents of the Bureau of Internal Revenue relative to defendant's income and financial affairs for the year 1915.

RICHARD S. HOLMES,

Sworn to before me this 4th day of December, 1920.

[SEAL.]

CARL BRECHER,
Notary Public, Kings County.

Clerk's No. 466, Register's No. 1213,
N. Y. Clerk's No. 569, Reg.'s No. 1560.
Commission expires March 30, 1921.

12 United States District Court, Southern District of New York.

L 24-77.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

Amended Answer.

Murray, Prentice & Aldrich, Attorneys for Defendant, 37 Wall Street, Manhattan, New York.

13 United States District Court, Southern District of New York.

L 24-77.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

The defendant above named, by Murray, Prentice & Aldrich, his attorneys, for his amended answer to the complaint herein:

I. Admits the allegations contained in the paragraph of the complaint numbered "Third" that during the calendar year ending December 31, 1915, defendant was the owner and holder of One hundred and fifty thousand three hundred and thirteen (150,313) shares of the capital stock of a certain corporation known as The Ohio Oil Company and that on or about the 4th day of February, 1915, defendant received Fifty thousand one hundred and four and 983-383/2950149 (50,104 983383/2950149) shares of the capital stock of a certain other corporation known as The Illinois Pipe Line Company of the par value of One hundred dollars (\$100) each; alleges that said shares of stock of The Illinois Pipe Line Company were

issued to and received by him pursuant to the proceedings and in the manner and under the circumstances alleged in the further and separate affirmative defense herein; denies each and every other allegation contained in said paragraph of the complaint numbered "Third" and particularly the allegations that said shares
14 of stock of The Illinois Pipe Line Company were paid to the defendant by The Ohio Oil Company and/or received by him as a dividend.

II. Admits the allegations contained in the paragraph of the complaint numbered "Fourth" that during the calendar year ending December 31, 1915, defendant was the owner and holder of Forty-four thousand seven hundred and eighty-four (44,784) shares of the capital stock of a certain corporation known as the Prairie Oil & Gas Company and that on or about the 25th day of March, 1915, defendant received Sixty-seven thousand one hundred and seventy-six (67,176) shares of the capital stock of a certain other corporation known as The Prairie Pipe Line Company of the par value of One hundred dollars (\$100) each; alleges that said shares of stock of The Prairie Pipe Line Company were issued to and received by him pursuant to the proceedings and in the manner and under the circumstances alleged in the further and separate affirmative defense herein; denies each and every other allegation contained in said paragraph of the complaint numbered "Fourth" and particularly the allegations that said shares of stock of The Prairie Pipe Line Company were paid to the defendant by The Prairie Oil & Gas Company and/or received by him as a dividend.

III. Admits the allegations contained in the paragraphs of the complaint numbered "Fifth," "Sixth," and "Ninth," except that defendant denies that the shares of stock of The Illinois Pipe Line Company and The Prairie Pipe Line Company referred to in said paragraphs were paid to or received by defendant in the manner alleged in the complaint, and alleges that said shares of stock
15 were issued to and received by him pursuant to the proceedings and in the manner and under the circumstances alleged in the further and separate affirmative defense herein.

IV. Admits the allegation contained in the paragraph of the complaint numbered "Eighth" that defendant failed to include in his return of the gains, profits and income received by or accrued to him during the calendar year ending December 31, 1915, filed with the Collector of Internal Revenue for the Third District of New York on or about the 28th day of March, 1916, any part of said shares of stock of The Illinois Pipe Line Company or any part of said shares of stock of The Prairie Pipe Line Company or the value of said shares and/or any part thereof; denies that said return was incorrect and/or misleading and/or false in that it failed to include the same, or for any other reason.

V. Admits the allegations contained in the paragraph of the complaint numbered "Eleventh" that the net income of defendant for the calendar year ending December 31, 1915, irrespective of said

shares of stock of The Illinois Pipe Line Company and/or The Prairie Pipe Line Company, was in excess of the sum of Five hundred thousand dollars (\$500,000) and that the difference between the market value of said shares of stock at the time the same were received by defendant and the par value of said shares of stock was Four million, eight hundred and seventy-seven thousand, nine hundred and seventy-nine 66/100 dollars (\$4,877,979.66); denies each and every other allegation contained in said paragraph of the complaint numbered "Eleventh."

VI. Admits the allegations contained in the paragraph of 16 the complaint numbered "Twelfth" that a demand has been made upon him for the sum of Two hundred ninety-two thousand, six hundred seventy-eight and 78/100 dollars (\$292,678.78) and that no payment on account of such demand has been made by him; denies each and every other allegation contained in the paragraph of the complaint numbered "Twelfth."

For a further, separate affirmative defense to the complaint herein, the defendant alleges:

VII. That during the year 1914, the Prairie Oil & Gas Company was a corporation duly organized and existing under and by virtue of the laws of the State of Kansas, and engaged in producing, purchasing and selling crude petroleum and transporting the same by pipe lines owned by it in the States of Kansas and Oklahoma and elsewhere. That at all the times hereinafter mentioned, The Prairie Oil & Gas Company had an authorized capital stock, all of which was issued and outstanding, of Eighteen million dollars (\$18,000,000) divided into One hundred and eighty thousand (180,000) shares of the par value of One hundred dollars (\$100) each.

VIII. That in June, 1914, it was judicially determined by the Supreme Court of the United States that The Prairie Oil & Gas Company was required to operate its pipe lines as a common carrier of oil in interstate commerce and as such was subject to the supervision of the Interstate Commerce Commission of the United States. That by Act of Congress, approved September 26, 1914, practically all of the business of The Prairie Oil & Gas Company, other than the operation of its pipe lines as a common carrier of oil in interstate commerce, was made subject to the supervision of the Federal Trade Commission.

17 IX. That in order to avoid the conflict of Federal authority in the regulation of the business of The Prairie Oil & Gas Company it was upon advice of counsel, considered advisable that the pipe line property be owned and operated by a corporation other than The Prairie Oil & Gas Company. That The Prairie Oil & Gas Company could not under its charter and the statutes of the State of Kansas acquire or hold the stock of a corporation owning and operating the pipe line property. That the stockholders of The Prairie Oil & Gas Company at the regular annual meeting held on December 8, 1914, adopted

the preambles and resolution, a copy of which is set forth in "Exhibit A" annexed hereto and made a part hereof and authorized the organization of a corporation for the purpose of owning and operating the pipe line property.

X. That thereafter and on or about December 8, 1914, pursuant to said resolution, the Board of Directors of The Prairie Oil & Gas Company caused a corporation to be organized under the laws of the State of Kansas, under the name of The Prairie Pipe Line Company with an authorized capital stock of Twenty-seven million dollars (\$27,000,000) divided into two hundred and seventy thousand (270,000) shares of the par value of one hundred dollars (\$100) each, and having authority under its charter to purchase, own and operate a system of pipe lines for the gathering and transmitting of oil, and The Prairie Pipe Line Company, pursuant to resolutions of its Board of Directors, a copy of which is set forth in "Exhibit B" annexed hereto and made a part hereof, offered to acquire the pipe line property owned by The Prairie Oil & Gas Company in consideration of the delivery of all of its capital stock. That said offer of The Prairie Pipe Line Company was accepted by The Prairie Oil & Gas Company at a meeting of its Board of Directors held on January 21, 1915, by the adoption of the preambles and resolution, a copy of which is set forth in "Exhibit C" annexed hereto and made a part hereof.

XI. That thereafter pursuant to said resolutions of the Board of Directors of The Prairie Oil & Gas Company and resolutions of the Board of Directors of The Prairie Pipe Line Company, a copy of which is set forth in "Exhibit D" annexed hereto and made a part hereof, there was executed an agreement dated January 21, 1915, a copy of which is set forth in "Exhibit E" annexed hereto and made a part hereof, which provided for the transfer of the pipe line property to The Prairie Pipe Line Company in consideration of the issue and delivery of all of its capital stock to The Prairie Oil & Gas Company, and which further provided that the pipe line property should include land, rights of way, equipment and working stocks of oil and that if the actual cost of the pipe line property to The Prairie Oil & Gas Company as shown in its investment records should not equal the sum of Twenty-seven million dollars (\$27,000,000), The Prairie Oil & Gas Company should pay to The Prairie Pipe Line Company such sum as might be necessary, when added to the value of such property, to equal the sum of Twenty-seven million dollars (\$27,000,000), and that if the cost of such property to The Prairie Oil & Gas Company as so determined should be in excess of the sum of Twenty-seven million dollars (\$27,000,000) The Prairie Pipe Line Company should pay to The Prairie Oil & Gas Company such excess in cash.

XII. That the Board of Directors of The Prairie Oil & Gas Company, at a meeting held on January 21, 1915, duly adopted the preambles and resolutions, a copy of which is

set forth in "Exhibit F" annexed hereto and made a part hereof, providing for the issue and distribution to the stockholders of The Prairie Oil & Gas Company, pro rata, of all of the capital stock of The Prairie Pipe Line Company.

XIII. That on or about February 1, 1915, the pipe line property was transferred to The Prairie Pipe Line Company and there was paid to it by The Prairie Oil & Gas Company the sum of One hundred and forty-one thousand, three hundred and sixty dollars and thirteen cents (\$141,360.13) in cash and The Prairie Pipe Line Company in accordance with said agreement between The Prairie Oil & Gas Company and The Prairie Pipe Line Company dated January 21, 1915, issued and caused to be distributed to each stockholder of The Prairie Oil & Gas Company a certificate or certificates representing a number of shares of the capital stock of The Prairie Pipe Line Company equal to one and one-half ($1\frac{1}{2}$) times the number of shares of the capital stock of The Prairie Oil & Gas Company standing in his or her name on the stock books of The Prairie Oil & Gas Company on February 9, 1915.

XIV. That upon the transfer of the pipe line property to The Prairie Pipe Line Company the pipe line property was taken up as an asset of The Prairie Pipe Line Company and eliminated as an asset of The Prairie Oil & Gas Company. That the shares of stock of The Prairie Pipe Line Company were at no time entered as an asset of The Prairie Oil & Gas Company. That on January 31, 1915, the following voucher entries were made:

20

	Debit.	Credit.
"The Prairie Pipe Line Company, Separation Account"	\$27,000,000.00	
Being the value of assets sold at close of business January 31st, 1915.		
The Prairie Pipe Line Company.		\$141,360.13

Being the difference between \$27,000,000.00 and \$26,858,638.87, the book value of the property sold to The Prairie Pipe Line Company.

NOTE.—Under the agreement dated January 21st, between The Prairie Oil & Gas Co. and The Prairie Pipe Line Company, it was agreed that in the event that the property sold to The Prairie Pipe Line Company did not equal the sum of \$27,000,000.00, the difference between the ascertained

value and \$27,000,000.00 was to be paid by The Prairie Oil & Gas Company to The Prairie Pipe Line Company in cash.

Investment:

Operated property, consisting of	
Pipe Lines, tanks, etc.....	25,292,378.91
Suspended Investment.....	25,398.91

Crude Oil Sales Account:

Crude Oil in working tanks	2,363,890.35 bbls.	
Less worthless	292,453.10 bbls.	
Merchantable Oil	2,071,437.25 bbls.	
	@.743519	1,540,152.95
Empty Sacks Account.....		568.60
Prest-O-Lite Cylinder Account ..		20.50
Ammonia Cylinder Account....		120.00
		<hr/>
	\$27,000,000.00	\$27,000,000.00

That the practice of The Prairie Oil & Gas Company was to charge to dividend account the amount of dividends paid and at the end of the year to charge off to profit and loss the amount of dividends paid during the year. That no entry was made in dividend account of The Prairie Oil & Gas Company in connection with this transaction. That there was charged off to profit and loss the sum of Twenty-seven million dollars (\$27,000,000). That on January 31, 1915, the following voucher entries were made:

	Debit.	Credit.
The Prairie Pipe Line Company		
Separation Account		\$27,000,000.00
Profit and Loss	\$27,000,000.00	

To close "The Prairie Pipe Line Separation Account" into Profit and Loss, being amount of assets sold The Prairie Pipe Line Company at date of organization of latter company.

That the surplus of The Prairie Oil & Gas Company amounted to the sum of Forty million, three hundred sixty-seven thousand, twenty-nine and 69/100 dollars (\$40,367,029.69) on March 1, 1913, the sum of Sixty million, seventy-one thousand, nine hundred twenty-four and 54/100 dollars (\$60,071,924.54) on January 31, 1915, immediately before the transfer of the pipe line property, and

the sum of Thirty-eight million, eight hundred fifty-one thousand, nine hundred seven and 06/100 dollars (\$38,851,907.06) on February 1, 1915, immediately after the completion of the transaction hereinbefore set forth. That on January 31, 1915, the following voucher entry was made:

	Debit.	Credit.
Depreciation on Property.....	\$5,784,992.51	
Profit and Loss.....		\$5,784,992.51

That all of the foregoing voucher entries were subsequently carried into the ledger.

22 XV. That approximately seventy-five per cent (75%) of the pipe line property transferred to The Prairie Pipe Line Company had been acquired by The Prairie Oil & Gas Company prior to March 1, 1913. That during the period of time prior to March 1, 1913, when such pipe line property was acquired, The Prairie Oil & Gas Company had in its treasury funds composed in part of the proceeds of the sale of its stock and bonds then outstanding and in part of earnings, and the money out of which the property in question was acquired was paid from such funds. That if the pipe line property owned by The Prairie Oil & Gas Company on March 1, 1913, and which was transferred to The Prairie Pipe Line Company had any greater value at the time of such transfer than it had on March 1, 1913, the amount of the increase in value was not equivalent to the par value of the shares of stock of The Prairie Pipe Line Company distributed to the stockholders of The Prairie Oil & Gas Company.

XVI. That after the transfer of the pipe line property of The Prairie Oil & Gas Company to The Prairie Pipe Line Company and the issue of the stock of The Prairie Pipe Line Company to the stockholders of The Prairie Oil & Gas Company, the asset or book value of the capital stock of The Prairie Oil & Gas Company was reduced to the extent of the asset or book value of the pipe line property, and the asset or book value of each share of the capital stock of The Prairie Oil & Gas Company was proportionately reduced.

XVII. That prior to the transfer of the pipe line property to The Prairie Pipe Line Company, sales of stock of The Prairie Oil & Gas Company had been made in the open market as follows:

23 January 4, 1915, at 464.
February 1, 1915, at 469.
February 4, 1915, at 465.

That after the transfer of the pipe line property, sales of stock of The Prairie Oil & Gas Company were made in the open market as follows:

February 10, 1915, at 219.
February 24, 1915, at 212.
March 1, 1915, at 224.

That sales of stock of The Prairie Pipe Line Company were made in the open market as follows:

February 10, 1915, at 146.

February 24, 1915, at 138.

March 1, 1915, at 150.

XVIII. That the value of the shares of the capital stock of The Prairie Oil & Gas Company owned by each stockholder, including the defendant, immediately prior to the transfer of the pipe line property to The Prairie Pipe Line Company, was substantially the same as the value of the shares of the capital stock of The Prairie Oil & Gas Company owned by each stockholder, including defendant, plus the value of the shares of the capital stock of The Prairie Pipe Line Company received by each stockholder of The Prairie Oil & Gas Company, including defendant, immediately after such transfer.

XIX. That on March 1, 1913, and on February 9, 1915, the defendant was the owner of 44,784 shares of the capital stock of The Prairie Oil & Gas Company, and received on or about March 25, 1915, under the distribution referred to in Paragraph XIII 24 certificates representing 67,176 shares of the capital stock of The Prairie Pipe Line Company. That none of said shares of the capital stock of The Prairie Pipe Line Company has been sold by the defendant.

XX. That during the year 1914 The Ohio Oil Company was a corporation duly organized and existing under and by virtue of the laws of the State of Ohio and engaged in producing and manufacturing petroleum and mineral oil and transporting oil and petroleum and its products by pipe lines owned by it in the States of Ohio, Indiana, Illinois and Pennsylvania. That at all the times hereinafter mentioned The Ohio Oil Company had an authorized capital stock, all of which was issued and outstanding, of Fifteen million dollars (\$15,000,000) divided into Six hundred thousand (600,000) shares of the par value of Twenty-five dollars (\$25) each.

XXI. That in June, 1914, it was judicially determined by the Supreme Court of the United States that The Ohio Oil Company was required to operate its pipe lines as a common carrier of oil in interstate commerce and as such was subject to the supervision of the Interstate Commerce Commission of the United States. That by Act of Congress approved September 26, 1914, practically all of the business of The Ohio Oil Company other than the operation of its pipe lines as a common carrier of oil in interstate commerce was made subject to the supervision of the Federal Trade Commission. That the gross receipts of the entire business of The Ohio Oil Company was subject to a tax of 4% per annum, imposed by Section 5487 of the Ohio General Code, upon the gross receipts of

25 companies engaged in transporting oil by pipe lines, although a large part of the gross receipts of The Ohio Oil Company was derived from business other than the business of transporting oil by pipe lines.

XXII. That in order to avoid the conflict of Federal authority in the regulation of the business of The Ohio Oil Company and to avoid the annual assessment of said 4% tax upon the gross receipts of the business of The Ohio Oil Company other than the business of transporting oil by pipe lines, it was upon advice of counsel considered advisable that the pipe line property be owned and operated by a corporation other than The Ohio Oil Company and that the stock of the corporation owning and operating the pipe line property should not be permanently held by The Ohio Oil Company. That on or about November 27, 1914 the Board of Directors of The Ohio Oil Company caused a corporation to be organized under the laws of the State of Ohio under the name of The Illinois Pipe Line Company, with an authorized capital stock of Twenty million dollars (\$20,000,000) and having authority under its charter to purchase, own and operate a system of pipe lines for the gathering and transmitting of oil.

XXIII. That the Board of Directors of The Ohio Oil Company, at a meeting held on November 30, 1914, a copy of the minutes of which is set forth in "Exhibit G" annexed hereto and made a part hereof, authorized a subscription on behalf of The Ohio Oil Company to One hundred ninety-nine thousand nine hundred and ninety-five (199,995) shares of the capital stock of The Illinois Pipe Line Company.

26 XXIV. That pursuant to the preamble and resolution adopted at a meeting of stockholders held on November 30, 1914, a copy of which is set forth in "Exhibit H" annexed hereto and made a part hereof, and the preamble and resolution adopted at a meeting of the Board of Directors held on November 30, 1914, a copy of which is set forth in "Exhibit I" annexed hereto and made a part hereof, The Illinois Pipe Line Company offered, by a certain instrument in writing dated November 30, 1914, a copy of which is set forth in "Exhibit J" annexed hereto and made a part hereof, to acquire the pipe line property owned by The Ohio Oil Company and Two hundred thousand dollars (\$200,000.00) in cash, and in consideration to issue all of its capital stock to The Ohio Oil Company, or to pay to The Ohio Oil Company Twenty million dollars (\$20,000,000) in cash or in cash and notes, as might be determined between The Ohio Oil Company and The Illinois Pipe Line Company.

XXV. That the Board of Directors of The Ohio Oil Company, at a meeting held on December 1, 1914, duly adopted the preambles and resolution, a copy of which is set forth in "Exhibit K" annexed hereto and made a part hereof, calling a special meeting of the stockholders of The Ohio Oil Company to be held on December 21, 1914.

XXVI. That said offer of The Illinois Pipe Line Company was accepted by the stockholders of The Ohio Oil Company at a meeting held on December 21, 1914, by the adoption of the preambles and resolutions, a copy of which is set forth in "Exhibit L" annexed hereto and made a part hereof.

XXVII. That between November 30, 1914 and January 1, 1915, it was determined between The Ohio Oil Company and The Illinois Pipe Line Company that in consideration of the transfer of the pipe line property The Illinois Pipe Line Company should issue all of its capital stock to The Ohio Oil Company, and should not pay the sum of Twenty Million Dollars (\$20,000,000) in cash or in cash and notes.

XXVIII. That the Board of Directors of The Ohio Oil Company at a meeting held on December 21, 1914, provided for the effectuation of the transfer of the pipe line property to The Illinois Pipe Line Company and the distribution of the stock of The Illinois Pipe Line Company among the stockholders of The Ohio Oil Company, pro rata, by the adoption of the preambles and resolutions, a copy of which is set forth in "Exhibit M" annexed hereto and made a part hereof.

XXIX. That on or about January 1, 1915, the pipe line property was transferred to The Illinois Pipe Line Company and The Illinois Pipe Line Company issued to The Ohio Oil Company a certificate representing Two hundred thousand (200,000) shares of its capital stock, the receipt for which is set forth in "Exhibit N" annexed hereto and made a part hereof, and The Ohio Oil Company surrendered said certificate to The Illinois Pipe Line Company with instructions to cancel the same and issue new certificates to the stockholders of The Ohio Oil Company so that each stockholder of The Ohio Oil Company should receive a certificate or certificates representing a number of shares of the capital stock of The Illinois Pipe Line Company equal to one-third ($1/3$) the number of shares of the capital stock of The Ohio Oil Company standing in his or her name on the stock books of The Ohio Oil Company on January 2, 1915, and pursuant to such instructions said new certificates were so issued and distributed.

XXX. That upon the transfer of the pipe line property to The Illinois Pipe Line Company the pipe line property was taken up as an asset of The Illinois Pipe Line Company and eliminated as an asset of The Ohio Oil Company. That the shares of stock of The Illinois Pipe Line Company were entered as an asset of The Ohio Oil Company. That the practice of The Ohio Oil Company was to charge to dividend account the amount of dividends paid and at the end of the year to charge off to profit and loss the amount of dividends paid during the year. That no entry was made in dividend account of The Ohio Oil Company in connection with this transaction. That there was charged off to profit and loss the sum of Twenty million dollars (\$20,000,000). That the following voucher entries were made:

Entry Dated January 1, 1915.

The Pipe Line Property of this company, located in the States of Illinois, Indiana, Ohio and Pennsylvania, consisting of complete Trunk Lines and Gathering Lines systems, together with the loose material appertaining thereto and \$200,000 in Cash, having been sold to the Illinois Pipe Line Company pursuant to action taken at meeting of Stockholders and meeting of Directors held on December 21, 1914, for 200,000 shares of the par value of \$100 each of the Capital Stock of The Illinois Pipe Line Company, the following entries are made in accordance therewith.

Stock of the Illinois Pipe Line Co.	\$20,000,000.00	
Pipe Line Investment.....		\$15,429,941.62
Material & Merchandise.....		18,437.59
Cash		200,000.00
Profit & Loss		4,351,620.79
	<u>20,000,000.00</u>	<u>20,000,000.00</u>

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Entry Dated January 1, 1915.

Entry to restore the Depreciation Reserve which had been established in the Books of this Company with respect to its Pipe Line Property, and which Property has been sold:

Depreciation on Property.....	5,467,075.52	
Profit & Loss.....		5,467,075.52

Entry Dated January 31, 1915.

The Directors of this Company having voted at meeting held on December 21, 1914, to distribute, pro rata, to stockholders of this company of record January 2, 1915, the Capital Stock of The Illinois Pipe Line Company, the following entry is made in accordance therewith.

Profit & Loss (Dividend).....	20,000,000.00	
Stock of The Illinois Pipe Line Co.		20,000,000.00

That all of the foregoing voucher entries were subsequently carried into the ledger.

That the surplus of The Ohio Oil Company amounted to the sum of Fifty-four million, twenty-four thousand, seven hundred forty-six and 63/100 dollars (\$54,024,746.63) on March 1, 1913, the sum of Sixty-eight million, eight hundred forty-nine thousand, four hundred twenty-seven and 49/100 dollars (\$68,849,427.49) on December 31, 1914, immediately before the transfer of the pipe line property, and the sum of Fifty-eight million, six hundred fifty-eight thousand, fifteen and 35/100 dollars (\$58,658,015.35) on January 31, 1915, after the completion of the transaction hereinbefore set forth.

XXXI. That on March 1, 1913, The Ohio Oil Company owned and had paid for all or a substantial percentage of the pipe line property which was subsequently transferred to The Illinois Pipe Line Company. That if the pipe line property owned by The Ohio Oil Company on March 1, 1913, and which was transferred to The Illinois Pipe Line Company had any greater value at the time of its transfer than on March 1, 1913, the amount of the increase in value was not equivalent to the par value of the stock of The Illinois Pipe Line Company distributed to the stockholders of The Ohio Oil Company.

XXXII. That after the transfer of the pipe line property of The Ohio Oil Company to The Illinois Pipe Line Company, and the distribution of the stock of The Illinois Pipe Line Company to the stockholders of The Ohio Oil Company, the asset or book value of the capital stock of The Ohio Oil Company was reduced to the extent of the asset or book value of the pipe line property and the asset or book value of each share of the capital stock of The Ohio Oil Company was proportionately reduced.

XXXIII. That prior to the transfer of the pipe line property to The Illinois Pipe Line Company sales of stock of The Ohio Oil Company had been made in the open market as follows:

December 1, 1914, at 187.
 December 26, 1914, at 188.
 December 30, 1914, at 186.

That after the transfer of the pipe line property sales of stock of The Ohio Oil Company were made in the open market as follows:

January 2, 1915, at 143.
 January 16, 1915, at 142.
 February 3, 1915, at 131.

That sales of stock of The Illinois Pipe Line Company were made in the open market as follows:

January 2, 1915, at 127.
 January 16, 1915, at 141.
 February 3, 1915, at 130.

XXXIV. That the value of the shares of the capital stock of The Ohio Oil Company owned by each stockholder, including the defendant, immediately prior to the transfer of the pipe line property of The Illinois Pipe Line Company was substantially the same as the value of the shares of the capital stock of The Ohio Oil Company owned by each stockholder, including the defendant, plus the value of the shares of the capital stock of The Illinois Pipe Line Company owned by each stockholder of The Ohio Oil Company, including the defendant, immediately after such transfer.

XXXV. That on March 1, 1913, and on January 1, 1915, the defendant was the owner of 150,313 shares of the capital stock of The Ohio Oil Company, and received on or about February 4, 1915, under the distribution referred to in Paragraph XXIX, certificates representing 50,104-983,383/2,950,149 shares of the capital stock of The Illinois Pipe Line Company. That none of said shares of the capital stock of The Illinois Pipe Line Company has been sold by the defendant.

XXXVI. That in accordance with the provisions of the Income Tax Law, being Section 2 of an Act of Congress of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes," the defendant, in the year 1916, duly filed his return of income received during the year 1915 and did not include therein as income any part of the value of said shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by him during the year 1915 as aforesaid.

32 XXXVI. That thereafter and on or about September 14, 1917, Mark Eisner, as Collector of Internal Revenue for the Third District of New York, claiming to act in pursuance of the provisions of said Section 2 of said Act of Congress of October 3, 1913, demanded of the defendant the sum of Seven hundred and fifty-four thousand seven hundred and thirty-seven 09/100 dollars (\$754,737.09) as an additional income tax for the year 1915. That included in said sum was the sum of seven hundred and three thousand, six hundred and eighty-one 99/100 dollars (\$703,681.99) which said Mark Eisner claimed to be due and payable by the defendant as an additional income tax for the year 1915 imposed upon the sum of Eleven million seven hundred and twenty-eight thousand thirty-three 34/100 dollars (\$11,728,033.34), being the equivalent of the par value of said 67,176 shares of stock of The Prairie Pipe Line Company and said 50,104-983,383/2,950,149 shares of stock of The Illinois Pipe Line Company received by the defendant in the year 1915 as aforesaid. That said Mark Eisner threatened to enforce the payment of said tax, together with penalties and interest, as provided in said Section 2 of said Act of Congress of October 3, 1913, and thereupon the defendant, solely to avoid the imposition of penalties and interest and the collection thereof, and under compulsion, duress and coercion, paid to said Mark Eisner, as such Collector, on or about September 24, 1917, the sum of Seven hundred and fifty-four thousand seven hundred and thirty-seven 09/100 dollars (\$754,737.09), included in which sum was the sum of seven hundred and three thousand, six hundred and eighty-one 99/100 (\$703,681.99) which represented the alleged tax imposed on the par value of said shares of stock of The Prairie Pipe Line Company and said shares of stock of The Illinois Pipe Line Company received by the defendant as aforesaid; but said payment was made under protest, and at the same time the defendant protested in writing that no tax was due from him on account of, or on account of the receipt

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of, said shares of stock or any thereof, and that said Mark Eisner was without authority to exact or collect the same or any part thereof, and that the defendant paid the same under duress and compulsion.

XXXVIII. That thereafter the defendant duly took an appeal to the Commissioner of Internal Revenue and demanded repayment and refund of the said alleged tax, in accordance with the law and the regulations and Rules of the Treasury Department. That said appeal was duly perfected and filed with the Commissioner of Internal Revenue on or about March 7, 1918, and that said appeal was disallowed by said Commissioner of Internal Revenue on or about May 24, 1919.

XXXIX. That neither under Section 2 of said Act of Congress of October 3, 1913, nor under any other law or statute of the United States, did the distribution of said shares of stock of The Prairie Pipe Line Company and said shares of stock of The Illinois Pipe Line Company to the defendant as aforesaid constitute a dividend, nor did the receipt thereof by the defendant constitute the receipt of a dividend or taxable income in any form, and no tax was due or has become due to the plaintiff on the value of said shares of stock received by the defendant as aforesaid, or any of them, or any part thereof, or on account of the receipt of said shares of stock or any thereof.

XL. That the Act of Congress under which said sum of Seven hundred and three thousand, six hundred and eighty-nine 99/100 dollars (\$703,681.99) was levied on the value of said shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company, or on account of the receipt thereof, and the payment of said sum compelled, and upon which the alleged cause of action set forth in the complaint is based, to wit: Section 2 of an Act of Congress of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes," is invalid and void in so far as the same may be asserted to confer power to make such levy or to sustain such alleged cause of action, because in violation of the provision of Article I, Section 2, Clause 3, of the Constitution of the United States, to the effect that "direct Taxes shall be apportioned among the several States," and of the provision of Article I, Section 9, Clause 4 thereof, to the effect that "no capitation or other direct tax shall be laid unless in proportion to the census of enumeration hereinbefore directed to be taken," and neither said shares of stock of The Prairie Pipe Line Company nor said shares of stock of The Illinois Pipe Line Company received by the defendant as aforesaid, nor any of them, nor any part of the value thereof, constituted income or was subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or

enumeration." And the defendant hereby draws in question the constitutionality of the said Act of Congress and of all of the provisions thereof assumed or asserted to authorize the said levy and the enforcement of the payment thereof, and to sustain the alleged cause of action set forth in the complaint.

Wherefore, the defendant demands judgment dismissing the complaint with costs to the defendant.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Defendant.

37 Wall Street, Manhattan, New York.

STATE OF NEW YORK,
County of New York, ss:

George Welwood Murray, being duly sworn, deposes and says:

I am a member of the firm of Murray, Prentice & Aldrich, the attorneys for the defendant herein, and have had charge of this case. I know the contents of the foregoing amended answer, and the same is true of my own knowledge except as to the matters therein stated to be alleged upon information and belief, and as to those matters I believe it to be true.

That the sources of my information and the grounds of my belief are information obtained from the officers of The Prairie Oil & Gas Company and The Ohio Oil Company, the books and papers of the defendant, and the communications addressed to the defendant by the Commissioner of Internal Revenue and the Collector of Internal Revenue for the Third District of the State of New York, and other correspondence, papers and documents.

GEO. WELWOOD MURRAY.

Sworn to before me this 30th day of June, 1921.

TALBOT M. MALCOLM,
Notary Public, New York County.

Clerk's No. 514, Register's No. 2472.
Commission expires March 30, 1922.

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EXHIBIT A.

Whereas, It has been determined in the United States Supreme Court, by opinion handed down on the twenty-second day of June, 1914, that The Prairie Oil & Gas Company is required to operate its pipe lines as a common carrier of oil in interstate commerce, and as such is subject to the supervision, regulation and control of the Interstate Commerce Commission; and

Whereas, The Prairie Oil & Gas Company is engaged almost wholly in such business as is interstate commerce according to law; and

Whereas, By Act of Congress, approved on the twenty-sixth day of September, 1914, practically all of the business of this company, aside from the transportation of oil in interstate commerce by means of pipe lines, is subjected to the supervision and regulation of the Federal Trade Commission; and

Whereas, By reason of the foregoing, it is considered by the stockholders of The Prairie Oil & Gas Company advisable that the branches of this company's business, which are subject to the supervision and regulation of the Interstate Commerce Commission, be separated in fact from the business subjected to the supervision and control of the Federal Trade Commission; and

Whereas, The said stockholders are advised and believe that this and can be best attained by and through the organization of a corporation which shall take over all the properties of The Prairie Oil & Gas Company of every nature and kind which may be reasonably necessary and essential to the conduct of the business of gathering and transporting oil in interstate commerce by means of pipe lines, and to prosecute, conduct and operate the business in which such property is now employed, and that The Prairie Oil & Gas Company discontinue the transaction and conduct of such business.

Now, Therefore, be it Resolved: That the Board of Directors of The Prairie Oil & Gas Company be, and said Board is hereby instructed, authorized and directed to procure the organization of a corporation under the laws of such one of the states as such Board shall select; to cause all of the property and funds of The Prairie Oil & Gas Company necessary or useful to the business of gathering and transporting oil by means of pipe lines in interstate commerce to be sold, conveyed and transferred to such new corporation, and to accept and receive in payment therefor the capital stock of such corporation, issued to, and for distribution among, the stockholders of The Prairie Oil & Gas Company pro rata according to their respective holdings in said The Prairie Oil & Gas Company, as may be shown by the stock records of said company on such day as shall be determined by the Board of Directors of this company after fourteen days' notice thereof shall have been mailed to each stockholder; provided that the par value of the capital stock of said corporation to be organized as aforesaid shall not exceed the reasonable value of its property and funds.

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EXHIBIT B.

Resolved: That a sub-committee composed of W. F. Gates and C. H. Kountz be appointed by this Board and authorized to negotiate with a committee appointed by The Prairie Oil & Gas Company to ascertain at what price and under what conditions The Prairie Oil & Gas Company might be willing to dispose of its pipe lines and other appurtenances necessary in the operation of the same (including private telephone and telegraph system) in the states of Indiana, Illinois, Iowa, Missouri, Kansas, Oklahoma and Arkansas; and that said committee conduct such negotiations as soon as possible and report the result of its negotiations to this Board for final action.

EXHIBIT C.

Whereas, The Prairie Pipe Line Company, a corporation, has been organized under the laws of the State of Kansas, with an authorized capital stock of Twenty-seven million (\$27,000,000) Dollars and authority under its charter to purchase, own and operate a system of pipe lines, such as is now owned and operated by this company for the gathering and transporting of crude oil;

And Whereas, said corporation, The Prairie Pipe Line Company, has made a proposition to purchase the pipe line property of
 40 The Prairie Oil & Gas Company, now owned and used by it in the gathering and transportation of crude oil, at fair and reasonable prices and deliver in payment therefor Twenty Seven Million (\$27,000,000) Dollars of the capital stock of said The Prairie Pipe Line Company, with the understanding and upon condition, however, that if the aggregate value of the property so sold and purchased, which cannot be at this date fully determined, shall exceed the sum of Twenty-Seven Million (\$27,000,000) Dollars. The Prairie Pipe Line Company will pay in cash an amount equal to such excess, and in case such amount, when fully determined, shall be less than Twenty-Seven Million (\$27,000,000) Dollars, then and in that event The Prairie Oil & Gas Company shall turn over to said Pipe Line Company an amount in cash which will make the combined value of such property sold and delivered and such cash turned over equal the sum of Twenty Seven Million (\$27,000,000) Dollars.

Now, Therefore, be it Resolved: That it is in the judgment of this Board of Directors and its individual members, to the interests of the stockholders that such sale and transfer be consummated in accordance with the resolution adopted at the stockholders' annual meeting, as aforesaid.

Be it Further Resolved: That a certain written contract for the consummation of the sale and transfer above described, which is this day submitted to this Board, by a special committee heretofore appointed to confer with The Prairie Pipe Line Company in
 41 this matter, in a manner satisfactory to this Board sets forth the basis, terms and conditions upon which The Prairie Oil & Gas Company, acting through its Board of Directors, desires such sale and transfer to be made.

And be it Further Resolved: That the President, J. E. O'Neil, be, and he is hereby, authorized and directed on behalf of The Prairie Oil & Gas Company to execute said contract in duplicate; that J. A. Hollihan, Secretary of The Prairie Oil & Gas Company, is authorized and directed to attest the same and attach the corporate seal of this company.

And be it Further Resolved: That all deeds, assignments, conveyances and other necessary papers and documents which may be required to be executed in the consummation of said contract and sale shall be executed on behalf of The Prairie Oil & Gas Company by W. S. Fitzpatrick, its Vice-President, and attested under the seal of this corporation by its Secretary.

EXHIBIT D.

Whereas, Growing out of negotiations heretofore conducted and considered between this Company and The Prairie Oil & Gas Company, relating to the purchase by this Company of the pipe line system owned and operated by The Prairie Oil & Gas Company in the gathering and transportation of crude oil and the property appurtenant thereto and used in connection therewith, said corporation, The Prairie Oil & Gas Company, has made a proposition to sell the pipe line property of The Prairie Oil & Gas Company, now owned and used by it in the gathering and transportation of crude oil, at fair and reasonable prices and receive in payment therefor Twenty Seven Million (\$27,000,000.00) Dollars of the capital stock of said The Prairie Pipe Line Company, with the understanding and upon condition, however, that if the aggregate value of the property so sold and purchased, which cannot at this date be fully determined, shall exceed the sum of Twenty Seven Million (\$27,000,000.00) Dollars, The Prairie Pipe Line Company will pay in cash an amount equal to such excess, and in case such amount, when fully determined, shall be less than Twenty Seven Million (\$27,000,000.00) Dollars, then and in that event The Prairie Oil & Gas Company shall pay to the said The Prairie Pipe Line Company an amount in cash which, when added to the value of such property sold and delivered, will equal the sum of Twenty Seven Million (\$27,000,000.00) Dollars.

Now, Therefore, be it Resolved, That the price at which said property is offered for sale, amounting in the aggregate to approximately Twenty Seven Million (\$27,000,000.00) Dollars, is a fair and reasonable price for the same and does not exceed the cost of present construction of a pipe line of equal length with equal capacity and equipment.

And be it Further Resolved, That a certain written contract for the consummation of the sale and transfer above described, which is this day submitted to this Board, by a special committee heretofore appointed to confer with The Prairie Oil & Gas Company in this matter, in a manner satisfactory to this Board sets forth the basis, terms and conditions upon which The Prairie Pipe Line Company, acting through its Board of Directors, desires such purchase to be made.

And be it Further Resolved, That the President, W. F. Gates, be, and he is hereby authorized and directed on behalf of The Prairie Pipe Line Company to execute said contract in duplicate; that F. M. Wilhelm, Secretary, is authorized and directed to attest the same and attach the corporate seal of this Company.

And be it Further Resolved, That upon the delivery to the Secretary of this Company by The Prairie Oil & Gas Company of a list of the stockholders of said Company, with the address of each stockholder and the amount of stock in The Prairie Pipe Line Company which it desires to have issued to each, not exceeding in the aggregate 270,000 shares, it is hereby ordered and directed that the Secre-

tary of this Company cause certificates for shares and fractions of shares to be issued in accordance with such list, and that when the stock of this Company is so issued the same shall be mailed by registered mail, with the knowledge, consent and under the supervision of the Secretary of The Prairie Oil & Gas Company, to the several persons to whom the same shall be issued at the address furnished by said The Prairie Oil & Gas Company, as aforesaid;

And be it Further Resolved, That C. H. Kountz, Vice-President, be and he is hereby authorized on behalf of The Prairie Pipe Line Company to make, execute and file all necessary tariffs, supplements and amendments to tariffs, either of The Prairie Oil & Gas Company or The Prairie Pipe Line Company, and all concurrences that may be required by law or the rules and regulations of the Interstate Commerce Commission in connection with the purchase, acquisition and taking over of the pipe lines of The Prairie Oil & Gas Company, and is further authorized and directed to demand from The Prairie Oil & Gas Company and to receive and approve such deeds, conveyances, assignments and title papers as may be necessary to vest in The Prairie Pipe Line Company the full ownership and possession of the property purchased under contract this day executed between The Prairie Oil & Gas Company and The Prairie Pipe Line Company.

EXHIBIT E.

This agreement, Made and entered into by and between The Prairie Oil and Gas Company, a corporation, party of the first part, and The Prairie Pipe Line Company, a corporation, party of the second part,

Witnesseth, That for and in consideration of the covenants, promises and agreements of the party of the second part, hereinafter set out, the party of the first part hereby undertakes and agrees that it will sell, convey, transfer, set over, and deliver to party of the second part all the pipe lines now owned and used by it in the gathering and transportation of oil in interstate commerce, together with all pumping stations, oil tanks, machinery and equipment of every nature and kind (including private telegraph and telephone lines), necessary or useful in the operation of said gathering lines and pipe lines, and all lands and rights-of-way upon which any or all of the property above mentioned and referred to shall be situated;

Second. Party of the first part will deliver to party of the second part all of the property above mentioned and referred to so that second party may begin on the 1st day of February, 1915, and thereafter continue, the transportation of oil throughout the system of such pipe lines, and that thereafter, as speedily as the same can be accomplished, first party will cause to be executed and delivered to second party the necessary deeds, conveyances, assignments, and other title papers, to the end that all the titles, rights, and privileges in, to, or connected with the ownership of first party to any and all

of the property hereinbefore mentioned and referred to shall be fully vested in The Prairie Pipe Line Company;

46 Third. Party of the second part hereby agrees to purchase all the property, rights, and privileges hereinbefore mentioned and referred to, and pay to The Prairie Oil and Gas Company therefor the actual cost of the same as shown by investment records of The Prairie Oil and Gas Company on the 31st day of January, 1915.

Fourth. Party of the second part agrees that in consideration of the sale, conveyance, transfer and delivery of the aforesaid property, which shall include the working stocks of oil in said pipe lines and tanks on the 1st day of February, 1915, it will issue and deliver to the party of the first part Two hundred Seventy Thousand (270,000) shares of its capital stock of the par value of One Hundred (\$100.00) Dollars per share, in such number of shares or fractions of shares as may be necessary for the actual distribution of such stock among the stockholders of The Prairie Oil and Gas Company, in accordance with a list to be furnished by said first party, showing the names and number of shares or the fraction of a share belonging to each, said list to be filed with the Secretary of the second party on or before the — day of March, 1915.

Fifth. It is mutually agreed between the parties hereto that if the aggregate cost of the property delivered to and received by party of the second part, determined in the manner aforesaid, shall not equal the sum of Twenty Seven Million (\$27,000,000.00) Dollars, the par value of the capital stock to be issued in exchange therefor, then and

47 in that case party of the first part shall pay to party of the second part in cash such sum as may be necessary, when added to the value of such property to equal Twenty Seven Million Dollars (\$27,000,000.00), and if the cost of such property, so delivered and received, shall be in excess of Twenty Seven Million (\$27,000,000.00) Dollars, then and in that case, party of the second part agrees to pay to party of the first part such excess in cash.

In Witness Whereof, This instrument is executed in duplicate by the President and Attested by the Secretary, under seal of each of the above named contracting parties, each having been first thereunto duly authorized by the Board of Directors of the respective companies which they represent, this the 21st day of January, 1915.

THE PRAIRIE OIL AND
GAS COMPANY,

By J. E. O'NEIL, *President*.

Attest:

J. A. HOLLIHAN,
Secretary.

THE PRAIRIE PIPE LINE
COMPANY,

By W. F. GATES, *President*.

Attest:

F. M. WILHELM, *Secretary.*

EXHIBIT F.

Whereas, The Prairie Oil & Gas Company, through its authorized officers, has this day entered into an agreement with the proper officials of The Prairie Pipe Line Company to sell to The Prairie Pipe Line Company its pipe lines with all appurtenances thereunto belonging, and to receive in payment therefor the capital stock of The Prairie Pipe Line Company, amounting to two hundred and seventy thousand (270,000) shares of the par value of One Hundred (\$100.00) Dollars each, or Twenty Seven Million (\$27,000,000) Dollars, and

Whereas, It is not the intention of this company to retain the aforesaid capital stock of The Prairie Pipe Line Company, but that it is the purpose of this company that such capital stock of The Prairie Pipe Line Company be distributed pro rata amongst the stockholders of The Prairie Oil & Gas Company in accordance with their holdings in said company on February 9th, 1915, as may be shown by the stock records of this company.

Now, Therefore, be it Resolved: That the stock transfer books of this company be and the same are hereby closed for the transfer of shares from and after February 9th, 1915, up to and including February 23rd, 1915.

Be it Further Resolved: That the Secretary of this company furnish to The Prairie Pipe Line Company a list of the stockholders of this company as shown by the stock books on February 9th, 1915, together with the number of shares held by each, and when The Prairie Pipe Line Company shall have issued to each of such stockholders its stock in amount equal to one and one-half times the amount of stock held by him or her in The Prairie Oil & Gas Company, then the said Secretary is hereby directed to make, or cause to be made, the proper distribution of such stock in The Prairie Pipe Line Company among the stockholders of The Prairie Oil & Gas Company, as above provided.

EXHIBIT G.

Directors' Meeting.

November 30th, 1914.

Meeting of the Directors of the Ohio Oil Company, Duly Called and Held at the General Office of said Company, in the City of Findlay, Ohio, on the 30th Day of November, A. D. 1914, at Ten o'clock, A. M., with J. C. Donnell, President, in the Chair.

Present: J. C. Donnell, R. J. Berry, O. D. Donnell and F. E. Hurley.

The Secretary read the minutes of the previous meeting, and on motion duly seconded same were approved as read.

The President stated that the Illinois Pipe Line Company had been incorporated under the Laws of the State of Ohio for the

purpose of transporting petroleum and water, and purchasing, leasing, acquiring, constructing, and holding and disposing of Pipe Lines and Pipe Line property, and it is the purpose of the Incorporators to make a proposition to The Ohio Oil Company to purchase its Pipe Line property in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems; and that the Books for Subscription to the Capital Stock of said The Illinois Pipe Line Company have been opened. Mr. F. E. Hurley then offered the following Resolution:

Resolved: That the President of this Company be, and he is hereby authorized to subscribe on behalf of The Ohio Oil Company to 199,995 shares of the Capital Stock of The Illinois Pipe Line Company, and to pay for the same at such time and in such installments as may be required by law, or by the Directors of said Corporation.

On motion of R. J. Berry, seconded by O. D. Donnell, the above Resolution was unanimously adopted.

There being no further business, the meeting on motion adjourned.

(Signed)

F. E. HURLEY,

Secretary.

EXHIBIT II.

Whereas: It being made known to the stockholders of this company that the pipe line property of The Ohio Oil Company, located in the states of Ohio, Indiana, Illinois and Pennsylvania, would be offered for sale, and it appearing desirable for the purposes of this company to acquire such property;

Be it therefore resolved: That the directors of this Company be authorized to make a proposition for the purchase of the pipe line property of The Ohio Oil Company located in the states of Ohio, Indiana, Illinois and Pennsylvania, including its trunk and gathering line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand dollars, and offer therefor the sum of twenty million dollars, and in case of the acceptance of said proposition by The Ohio Oil Company, that the directors be, and they are hereby authorized and directed to do all the things necessary or proper to carry into effect and complete the purchase of said property.

EXHIBIT I.

Whereas: The stockholders of this company have authorized the directors to make a proposition to The Ohio Oil Company for the purchase of the pipe line property of The Ohio Oil Company in Ohio, Indiana, Illinois and Pennsylvania, including its trunk and gathering pipe line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand dollars, and to offer therefor the sum of twenty million dollars.

Now, Therefore, be it Resolved: That the President of this company be, and he is hereby authorized and directed in accordance with

the authorization and instruction of the stockholders of the company, to make the following proposition to the said The Ohio Oil Company for the purchase of said pipe line property.

The Illinois Pipe Line Company, a corporation organized under the laws of the state of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand dollars, in accordance with the schedule attached hereto which has been furnished to The Illinois Pipe Line Company by The Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition.

The Illinois Pipe Line Company agrees to pay for said property and cash the sum of twenty million dollars, which payment shall be made in cash, or in cash and notes, or in the paid up capital stock of this company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition, the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable.

53

EXHIBIT J.

Findlay, Ohio, November 30, 1914.

To the Ohio Oil Company:

The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the States of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand (\$200,000.00) Dollars, in accordance with the schedule attached hereto which has been furnished to the Illinois Pipe Line Company by The Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition.

The Illinois Pipe Line Company agrees to pay for said property the sum of \$20,000,000, which payment shall be made in cash, or in cash and notes, or in the paid up capital stock of this Company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable.

THE ILLINOIS PIPE LINE
COMPANY,
By J. R. PENN, Jr.,
President.

EXHIBIT K.

Whereas The Illinois Pipe Line Company has made the following proposition to The Ohio Oil Company for the purchase of its pipe line property:

The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto and cash in the sum of Two Hundred Thousand Dollars, in accordance with the schedule attached hereto which has been furnished to The Illinois Pipe Line Company by the Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition. The Illinois Pipe Line Company agrees to pay for said property the sum of \$20,000,000.00, which payment shall be made in cash, or in cash and notes, or in the paid up Capital Stock of this Company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition, the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable."

And Whereas: On account of the importance of the question involved in said proposition, it is the sense of this board that the same should be submitted to the stockholders of the Company for determination; therefore,

Be it Resolved: That a special meeting of the stockholders of The Ohio Oil Company be called and held at its principal office in the City of Findlay, Ohio, on the 21st day of December A. D., 1914, at ten o'clock, A. M., of that day, for the purpose of considering and acting upon the proposition made by The Illinois Pipe Line Company, and that the Secretary be, and he is hereby instructed and directed to mail to all stockholders proper notice of said meeting, setting forth the time and place of the same, and the purpose for which it is to be held.

EXHIBIT L.

Whereas, The Board of Directors of The Ohio Oil Company has received the following proposition from The Illinois Pipe Line Company to purchase its pipe line property:

"The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto and cash in the sum of Two hundred thousand dollars, in accordance with the schedule attached hereto which has been furnished to The Illinois Pipe Line Company by The Ohio Oil Company in a preliminary

negotiation for this property, and which schedule is made a part of this proposition.

"The Illinois Pipe Line Company agrees to pay for said property the sum of \$20,000,000, which payment shall be made in cash, or in cash and notes, or in the paid up Capital Stock of this Company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition, the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable."

Now, therefore, be it resolved, that the said proposition be and the same is hereby accepted and that the Board of Directors of this Company be and hereby are fully authorized, instructed and empowered to accept the said proposition for the sale of all the Company's pipe line property, including both the trunk and gathering pipe line systems with the equipment belonging thereto and located in the states of Ohio, Indiana, Illinois and Pennsylvania; and

Further resolved, that the Board of Directors of this Company be and hereby are authorized, instructed and empowered to sell and dispose of said pipe line property, including both the trunk and gathering pipe line systems with the equipment belonging thereto as aforesaid, together with cash in the sum of Two hundred thousand dollars, at such time and upon such terms and conditions

57 as is provided in said proposition and as to them may seem best, hereby giving said Board of Directors full power and authority to act in behalf of The Ohio Oil Company in the sale of its said pipe line property, and to do all things necessary for the proper consummation of the sale and transfer of the said pipe line property.

EXHIBIT M.

Whereas, The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, has made a proposition to purchase all of The Ohio Oil Company's pipe line property, including both the trunk and gathering pipe line systems with the equipment belonging thereto and located in the states of Ohio, Indiana, Illinois and Pennsylvania, and to pay therefor the sum of \$20,000,000, which payment shall be made in cash, or in cash and notes, or in the paid up Capital Stock of The Illinois Pipe Line Company; and

Whereas, the stockholders of The Ohio Oil Company have duly and regularly approved of said proposition and authorized and directed that the said Board of Directors sell said pipe line property at such time and upon such terms and conditions as are provided in said proposition and as to them may seem best;

58 Now, therefore, be it resolved, That the said proposition be and the same is hereby accepted by this Company; and that the Board of Directors of The Ohio Oil Company hereby agrees to sell and convey to The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, all of its said pipe line property, including both the trunk and gathering pipe line systems, with the equipment belonging thereto and located in

the states of Ohio, Indiana, Illinois and Pennsylvania, and cash in the sum of Two Hundred Thousand Dollars, upon the following terms, to wit: Payment by The Illinois Pipe Line Company of 200,000 shares of its Capital Stock of the par value of \$20,000,-000.00; transfer of said property to take effect as of January 1st, 1915.

Further resolved, That the President, or one of the Vice-Presidents, and the Secretary of the Company are hereby empowered and instructed to execute all proper instruments to carry such acceptance into effect and on behalf of this Company to receive the said 200,000 shares of the Capital Stock of The Illinois Pipe Line Company, and to do all such other things in connection with such sale and the said transfer of the property as may be found necessary for its proper consummation.

Whereas, by reason of the sale of its pipe line property, The Ohio Oil Company will receive on January 1st, 1915, the entire Capital Stock of The Illinois Pipe Line Company, consisting of 200,000 shares of the par value of \$100.00 per share; and

Whereas, it is the sense of this board that a distribution of said stock should be made to the stockholders of this Company;

Now, therefore, be it resolved, That a pro rata distribution of said stock be made to stockholders of The Ohio Oil Company of record January 2nd, 1915, and that certificates representing said stock be mailed to stockholders on February 1st, 1915, or as soon thereafter as possible; and further, that the transfer books of this Company be closed from 12 o'clock m. on January 2nd, 1915, until 8 o'clock a. m., February 1st, 1915.

EXHIBIT N.

Findlay, Ohio, January 1st, 1915.

Received of The Illinois Pipe Line Company Certificate No. 1, for Two Hundred Thousand (200,000) Shares of the Capital Stock of said The Illinois Pipe Line Company, of the par value of One Hundred Dollars (\$100.00) each, said Stock being in payment for the Pipe Line property of The Ohio Oil Company located in the States of Ohio, Indiana, Illinois and Pennsylvania, including both the Trunk and Gathering Pipe Line Systems, with the equipment belonging thereto, and cash in the sum of Two Hundred Thousand (\$200,000.00) Dollars, pursuant to a proposition made to The Ohio Oil Company, under date of November 30th, 1914, and in accordance with the schedule attached to and made a part of said proposition, and which said proposition was accepted by The Ohio Oil Company.

By agreement between The Ohio Oil Company and The Illinois Pipe Line Company the transfer of said property takes effect as of January 1st, 1915. All of the instruments necessary to pass title to rights of way, real estate, etc., to The Illinois Pipe Line Company,

have not yet been made, but these instruments will be made and executed with all possible dispatch.

THE OHIO OIL COMPANY,
By J. C. DONNELL, *President*.

61 United States District Court, Southern District of New York.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

The plaintiff above-named by William Hayward, United States Attorney for the Southern District of New York, its attorney, demurs to the affirmative defense set forth in the amended answer herein upon the ground that the same is insufficient in law upon the face thereof.

Wherefore, plaintiff demands judgment and that said affirmative defense be dismissed.

WILLIAM HAYWARD,
*United States Attorney for the Southern District of
New York, Attorney for Plaintiff.*

Office and Post Office Address, United States Courts and Post Office Building, Borough of Manhattan, City of New York.

62 United States District Court, Southern District of New York.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

Please to take notice that upon the complaint, amended answer and plaintiff's demurrer to the affirmative defense therein, the undersigned will move this Court at a Stated Term thereof for the hearing of motions to be held at the United States Courts and Post Office Building in the Borough of Manhattan, City, County, State and Southern District of New York, on the 30th day of June, 1921, at 10 o'clock in the forenoon of said day, or as soon thereafter as counsel can be heard, for an order granting to the plaintiff judgment upon the pleadings and granting to said plaintiff such other further and general relief as to the Court in the premises may seem just and proper.

Dated: June 28, 1921.

Yours, etc.,

WILLIAM HAYWARD,
*United States Attorney for the Southern District of
New York, Attorney for Plaintiff.*

Office and Post Office Address: U. S. Courts and Post Office Building, Borough of Manhattan, City of New York.

To Murray, Prentice & Aldrich, Esqs., Attorneys for Defendant.

[Endorsed:] 24-77. Court Docket No. —, Form No.

336. U. S. District Court, Southern District of New York.

The United States of America, Plaintiff, versus John D. Rockefeller, Defendant. Demurrer and Notice of Motion. William Hayward, United States Attorney, Attorney for Pltf.

United States District Court, Southern District of New York.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

SIR:

Please take notice that upon the complaint, amended answer and plaintiff's demurrer to the affirmative defenses therein, the undersigned will move this court at a stated term thereof for the hearing of motions to be held at the United States Court and Post Office Building, in the Borough of Manhattan, City, County and State of New York, on the 30th day of June, 1921, at 10 o'clock in the forenoon or as soon thereafter as counsel can be heard for an order granting to the defendant judgment on the pleadings and granting to defendant all such other and further relief as to the court may seem just and proper.

Yours, etc.,

MURRAY, PRENTICE & ALDRICH,
Attorneys for Defendant.

Office and P. O. Address, 37 Wall Street, New York City.

To Francis G. Caffey, Attorney for Plaintiff, U. S. P. O. Building, New York City.

United States District Court, Southern District of New York.

NEW YORK TRUST COMPANY and Others, as Executors of William L. Harkness,

against

WILLIAM H. EDWARDS, Collector.

UNITED STATES OF AMERICA

against

JOHN D. ROCKEFELLER.

These cases involve the legality of the income tax levied upon the plaintiff in the Harkness case and the defendant in the Rockefeller case. The question turns on the effect of certain corporate actions taken by the Prairie Oil & Gas Company and the Ohio Oil Company during the winter of 1914-15.

The Prairie Oil & Gas Company was the owner of pipe line property and oil property and for reasons not here relevant felt itself forced to separate these two into two separate corporations. In pursuance of that purpose it caused a corporation to be organized known as the The Prairie Pipe Line Company. It then made a contract with the pipe line company by which it was to convey all its pipe line property to it, in consideration of which the pipe line company promised to distribute all its own stock to the stockholders of the oil company in the same proportion as their existing holdings. This was carried out and the shares of the pipe line company so received by Harkness and Rockefeller were taxed as part of their income for the year in which the shares were issued.

66 The transaction in the case of the Ohio Oil Company was similar except that the agreement between it and the Illinois Pipe Line Company, which it organized, required the shares to be transferred direct to the oil company. However, the resolution of the directors of the oil company which accepted the contract, declared as a dividend all the shares to be received from the pipe line company and directed them to be distributed among its stockholders in accordance with their existing holdings. This agreement was carried out as well, and the shares so declared were also taxed as income against Harkness and Rockefeller as in the case of the Prairie Oil & Gas Company. In both cases the pipe line properties represented a surplus above the par value of the oil companies' stock; the conveyances therefore left the oil companies' capital unimpaired and required no reduction in their authorized issues.

Richard S. Holmes, Charles A. Mapes and Newton K. Fox for the United States.

George Wellwood Murray and Harrison Tweed for Harkness and Rockefeller.

LEARNED HAND, D. J.:

Neither the Prairie Gas & Oil Company nor the Ohio Oil Company for any moment of time owned the pipe line shares as free assets. This is very clear in the case of the Prairie Company, the transaction in which,—observing now the most scrupulous formality,—was this. The pipe line company offered to buy the oil company's pipe line assets for \$27,000,000,—adjusted to actual values,—and to give in payment its own shares to be directly distributed by the pipe line company pro rata among the oil company's stockholders. This offer the oil company accepted and the contract of January 21, 1915,

67 bound the buyer to distribute the stock, which it did. This was a contract made for the sole benefit of the oil company's stockholders and could probably have been directly enforced by them at law, *Hendrick v. Lindsay*, 93 U. S. 143, *National Bank v. Grand Lodge*, 98 U. S. 123, 124, (semble). Yet it was the only contract by which the oil company ever got any conceivable interest in the pipe line shares, and it gave that company no such interest. It had given away its property for a consideration moving directly to third persons.

In the case of the Ohio company, formally the contract bound the pipe line company to deliver its shares to the oil company and they thus would have become free assets, if there had been nothing more. However, in the very resolution of the oil company's board of directors by which the offer of the pipe line company was accepted the board declared a pro rata distribution of the pipe line shares among its own stockholders. Thus at the moment of concluding the contract by which alone the oil company got any interest in the shares, the property so acquired was declared as a dividend. That declaration gave the stockholders of the oil company an immediate vested right to the dividend so declared, *Staats v. Biograph Co.*, 235 Fed. R. 454, (C. C. A. 2nd), *Hopper v. Sage*, 112 N. Y. 530, *Raynolds v. Diamond Mills Paper Co.*, 69 N. J. Eq. 299, 300.

Therefore I think that *Peabody v. Eisner*, 247 U. S. 347, does not apply. I agree that had these shares been once free treasury assets it would be impossible to distinguish that case; the dividend would have been declared in specific property. But since the shares even in the case of the Ohio company were always the property of the stockholders the transactions must be taken as a whole, and the case determined from their effect upon the rights of the stockholders.

A dividend may be income to the stockholder though declared out of property which has long since become a part of the economic capital of the corporation, *Peabody v. Eisner*, supra, *Lynch v. Hornby*, 247 U. S. 339. True, it must not be a dividend in liquidation, *Lynch v. Turrish*, 247 U. S. 221, and perhaps it must be that account be from a corporate surplus, since otherwise it is hard to avoid regarding it as in liquidation. But it makes no difference that it distributes to the stockholder property which is not current profit, but the means of producing current profit. He must still pay an income tax upon it, though in his eyes it is a part of his capital. Therefore, in the cases at bar, the only question is of the completeness of severance of the property declared, i. e., the control of it acquired by the stockholder and lost by the corporation.

In *Eisner v. Macomber*, 252 U. S. 189, the case was of a mere stock dividend, which was held to be no more than new evidence of the stockholder's original ownership. Had the shares been without par value, that would have been literally the case, but they were not. The stock dividend did change the relation of the corporation and the stockholder to the surplus, by permanently impounding it, as it were, in the business, and giving the stockholder a right to insist upon it as an investment, should his fellows later wish to realize it as profit. Yet though he thus got, and the corporation lost, this element of control over the surplus so declared, it was not regarded as a severance of the property. So far, therefore, *Eisner v. Macomber*, supra, helps the taxpayers here; it shows that there may be some changes in the relation of the stockholders to the surplus which do not amount to the severance of income.

Nevertheless, the cases at bar go further than that case because in them the surplus was transferred to a new corporation altogether, and the question is whether that distinction changes the result. The taxpayers insist that if one looks at the very truth of

the matter, disregarding corporate forms, this is no difference at all. Although the argument is plausible, it still seems to me, that, even when viewed with the completest disregard of forms, the pipe line properties were completely severed from the oil companies and that the resulting shares were new property derived from the old shares.

A corporation, stripped of its fictitious personality, is an association of persons mutually agreed upon the execution of more or less definitely expressed purposes, publicly registered as the law requires. In the case of industrial corporations the personnel of the membership is an immaterial matter; the original members leave as they please and their substitutes enter merely by purchase. Even the number of the members changes from time to time. If so, it is the common purposes and their execution alone that determine the corporation and whatever substantially changes these changes the corporation itself, and the rights of its stockholders.

The result of the conveyance of the pipe line property was to put it under the control of an association committed exclusively to its operation as a separate enterprise from that of the oil company. Indeed, this severance in management was the sole motive of the transaction, unless there were a surreptitious agreement between the two groups which nullified the dissolution, which is not suggested. Accepting therefore, the taxpayers' argument that forms should be disregarded, the question is whether a group mutually agreeing

70 to manage the pipe line property independently of the oil property, is a different group from one agreeing to manage the pipe line and the oil property jointly. If the association does not depend upon the number or makeup of its membership but upon its charter, there can be no question that the difference between the two is substantial, because to conduct two businesses as a unity has practical results very different from conducting them in complete interdependence.

For illustration let me assume that the pipe line property had been conveyed in specie to the stockholders as co-owners and that they had incorporated for convenience. The original conveyance to them would have fallen directly within *Peabody v. Eisner*, supra, and *Lynch v. Hornby*, supra. It would have made no difference that they had later incorporated. Yet judged by results, this is exactly what happened; the pipe line was broken from an association committed to its joint management with the oil properties and consigned to an association which must manage it alone.

Or suppose that the *Prairie Pipe Line Company*, for example, had been a going concern with property of its own. Upon its acquisition of the pipe line and the issue of its new shares to the oil company stockholders, they would have an interest in an association operating two properties? These new shares would certainly be income in their hands to some extent. Would they be altogether income or only in the proportion to which by taking the new shares they gave up their rights in the old pipe line and got in exchange an interest in the original property of the *Prairie Pipe Line Company*? I scarcely think that anyone would urge that the new shares were not altogether income. Yet, if so, they would become such only because

the pipe line was being conducted in a new joint enterprise by the Prairie Pipe Line Company. Unquestionably the oil company stockholders would to some extent be still holding their old pipe lines and in the same relative proportions.

Or consider again the analogy of many of the dissolutions under the Sherman Act. These consisted in no greater separation than was accomplished here, yet it was thought enough to sever the enterprises and create new rights in the new corporations. Nor was it thought to be an answer that the stockholders started out the same. Because the members might join or leave the new group which conducted only a part of the old business, it was considered that the old group was effectively broken up.

Disregarding, therefore, all formalities, it appears to me, that the pipe-line properties were as effectually severed from the old corporations as though they had been distributed in kind. Indeed, the form adopted was the only practicable way in which they could be so distributed. It is only when one fastens one's attention upon the momentary identity of the two resulting groups that there can be any question of the result. But, as I have perhaps too often said, that identity is nothing unless its continuance is insured for the future by some common agreement between the two. I think that the new shares were income under the law and that the tax was legal.

Southern Pac. Co. v. Lowe, 247 U. S. 330, is not to the contrary; there the assets taken over had always been in the actual possession and under the control of the corporation. All the shares of the subsidiary were owned by it and the two were treated as merged. Nothing of the sort is true in the cases at bar. In Gulf Oil Com-

pany v. Lewellyn, 248 U. S. 71, it is indeed true that the property of the subsidiaries was not in the possession of the parent corporation, but it owned all their shares, and they were all "a single enterprise", controlled by it. In no sense did the pipe line companies and the oil companies here remain "a single enterprise". They might in fact be so conducted for a period, but if so, it would only be by the spontaneous assent of two independent groups of persons. If they remained in fact "a single enterprise", the whole plan was a mere cover.

Phellis v. U. S. Court of Claims, March, 1921, was a case where all the assets were sold to another corporation, which,—omitting irrelevant details,—gave its own shares, two for one, to the old stockholders and conveyed its debenture shares to the old company par for par. The result was that the old stockholders had their old shares now represented by the assets of the old corporation, i. e., the debenture shares in the new corporation, and double their original holdings in common shares of the new corporation. Whatever may be the proper answer to the case, with the greatest deference I cannot follow the reasoning of the learned judge, now urged upon me as authoritative. That reasoning is that because the joint value of the old and new shares after the transfer was the same as that of the old shares before, there can have been no income to the stockholder. It may of course happen that in the case of the dis-

tribution of the dividends, the value of the old shares does not fall as much as the value of the dividend, though generally the correspondence is pretty close. It does not make any difference for taxing purposes whether it does or not. The surplus declared as dividend may or may not be represented in the value of the shares, but even though it be fully represented, the dividend becomes income, as soon as the stockholder gets it. On his books it may appear

73 as a capital distribution, depending on whether he carries his investment at par. That is not to the point. It was not his property before, it has become such by the declaration of the dividend.

Demurrers sustained; judgment absolute on the demurrers, dismissing Harkness's complaint and awarding recovery against Rockefeller as prayed.

L. H.,
D. J.

August 3, 1921.

74 At a Stated Term of the United States District Court for the Southern District of New York Held in the United States Court and Post Office Building, Borough of Manhattan, City, County, and State of New York, on the 8th Day of September, 1921.

Present: Honorable Learned Hand, District Judge.

UNITED STATES OF AMERICA, Plaintiff,
against

JOHN D. ROCKEFELLER, Defendant.

Plaintiff herein having moved this Court for judgment upon the pleadings upon the complaint, the amended answer and the demurrer to the affirmative defense contained in said amended answer and defendant having made a cross-motion for judgment upon said pleadings and said motions having duly come on to be heard by this Court.

Now, after hearing Richard S. Holmes, Esq., Special Assistant United States Attorney for the Southern District of New York, of counsel for the plaintiff, in support of plaintiff's motion for judgment on the pleadings and in opposition to defendant's motion and after hearing George Welwood Murray, Esq., of counsel for the defendant in opposition to plaintiff's said motion and in support of defendant's said motion, and due deliberation having been had thereon, upon motion of William Haywood United States Attorney for the Southern District of New York, attorney for plaintiff, it is

75 Ordered that the motion of defendant for judgment upon the pleadings herein be and the same hereby is in all respects denied, and it is

Further ordered that the motion of the plaintiff for judgment upon the pleadings herein be and the same hereby is in all respects granted, and it is

Further ordered that the plaintiff herein have final judgment against the defendant for the sum of Two hundred ninety-two thousand and six hundred seventy-eight dollars and seventy-eight cents (\$292,678.78) with interest thereon at the rate of six per cent per annum from the 30th day of June, 1916 and for its costs to be taxed.

LEARNED HAND,
U. S. D. J.

76 United States District Court, Southern District of New York.

UNITED STATES OF AMERICA, Plaintiff,

against

JOHN D. ROCKEFELLER, Defendant.

Plaintiff herein having moved for judgment upon the pleadings upon the complaint, the amended answer and the plaintiff's demurrer to the affirmative defense contained in said amended answer and defendant having made a cross-motion for judgment upon said pleadings and said motions having duly come on to be heard before the Honorable Learned Hand, United States District Judge, at a stated term of this Court held on the 1st day of July, 1921, and Richard S. Holmes, Special Assistant United States Attorney for the Southern District of New York, of counsel for the plaintiff, having been heard in support of plaintiff's motion and in opposition to defendant's motion, and George Welwood Murray, Esq., of counsel for the defendant, having been heard in opposition to plaintiff's said motion and in support of defendant's said motion and due deliberation having been had thereon, and the Court having handed down its opinion on the 3rd day of August, 1921, granting plaintiff's said motion and denying defendant's said motion and an order having been duly made and entered on the 8th day of September, 1921, granting plaintiff's said motion and denying defendant's said motion and ordering

77 that plaintiff have final judgment against the defendant for the sum of Two hundred ninety-two thousand, six hundred seventy-eight and 78/100 dollars (\$292,678.78), with interest thereon at the rate of six per centum per annum from the 30th day of June, 1916, and for its costs to be taxed and the costs of the plaintiff having been taxed in the sum of Forty three and 37/100 dollars (\$43.37),

Now, on motion of William Hayward, United States Attorney for the Southern District of New York, attorney for plaintiff, it is

Adjudged that plaintiff have and recover of the defendant the sum of Two hundred ninety-two thousand, six hundred seventy-eight and 78/100 dollars (\$292,678.78), together with the sum of Ninety-one thousand, one hundred and sixty-nine and 44/100 dollars (\$91,169.44), interest thereon at the rate of six per centum per annum

from the 30th day of June, 1916, and the sum of Forty three and 37/100 dollars (\$43.37), costs of the plaintiff as taxed, in all the sum of Three Hundred and Eighty three thousand eight hundred and ninety one and 59/100 Dollars (\$383,891.59), and that plaintiff have execution against said defendant therefor.

Judgment signed this 9th day of September, 1921.

[SEAL.]

ALEX. GILCHRIST, JR.,
Clerk.

78 [Endorsed:] Court Docket No. —. Form No. 336. U. S. District Court, Southern District of New York. The United States of America, Plaintiff, versus John D. Rockefeller, Defendant. Judgment. William Hayward, United States Attorney, Attorney for Plaintiff.

79 United States District Court, Southern District of New York.

L. 24-77.

UNITED STATES OF AMERICA, Plaintiff,
against

JOHN D. ROCKEFELLER, Defendant.

Petition for Writ of Error.

To the United States Supreme Court:

The above named John D. Rockefeller, now appears before this Court and complains that in the records and proceedings had in this cause, and also in the rendition of the judgment in the above entitled cause in the United States District Court, for the Southern District of New York, on the 9th day of September, 1921, manifest error hath happened to the great damage of said defendant, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore the said defendant hereby prays for the allowance of a writ of error, for an order fixing the amount of the bond for a supersedeas in the said cause, and for such other order and process as may cause the aforementioned errors and judgment to be corrected by said United States Supreme Court.

Dated New York, September 10th, 1921.

GEORGE WELWOOD MURRAY,
Attorney for Defendant.

37 Wall Street, New York, N. Y.

80 [Endorsed:] L. 24-77. United States District Court, Southern District of New York. United States of America, Plaintiff, against John D. Rockefeller, Defendant. Petition for writ of error. Murray, Prentice & Aldrich, Attorneys for defendant, 37 Wall Street, New York.

- 81 At a Stated Term of the District Court of the United States Held in and for the Southern District of New York, at the Courthouse, in the U. S. Post Office, at the Courthouse Building, in the Borough of Manhattan, City of New York, on the 10th Day of September, 1921.

Present: Hon. Julius M. Mayer, U. S. District Judge.

THE UNITED STATES OF AMERICA, Plaintiff,
against

JOHN D. ROCKEFELLER, Defendant.

The above named defendant, John D. Rockefeller, having filed a petition for a writ of error and an assignment of errors in the above entitled action, and upon filing a bond in the sum of Two hundred & fifty dollars, to be approved by the Court, it is now

Ordered that a writ of error be and the same hereby is allowed to have reviewed in the United States Supreme Court the record and proceedings and the judgment heretofore and on the 9th day of September, 1921, rendered in this Court in this cause and it is

Further ordered that the said bond shall operate as a supersedeas bond, provided, however, that, if required by the plaintiff, a further bond in a sum not to exceed the amount of said judgment shall be given.

J. M. MAYER,
U. S. District Judge.

- 82 [Endorsed:] L. 24-77. United States District Court, Southern District of New York. The United States of America, Plaintiff, against John D. Rockefeller, Defendant. Order Allowing Writ of Error. Murray, Prentice & Aldrich, Attorneys for Defendant, 37 Wall Street, New York.

- 83 United States District Court, Southern District of New York.

UNITED STATES OF AMERICA, Plaintiff,
against

JOHN D. ROCKEFELLER, Defendant.

Assignment of Errors.

Now comes John D. Rockefeller, the defendant herein, and assigns error in the decision of the United States District Court for the Southern District of New York as follows:

First. The Court erred in sustaining the demurrer interposed by the plaintiff to the affirmative defense set forth in the amended answer herein, in sustaining the plaintiff's motion for judgment on the pleadings, in overruling the defendant's cross-motion for judgment

on the pleadings, and in directing that final judgment should be entered in favor of the plaintiff.

Second. The Court erred in holding that Section 2 of the Act of Congress of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes," upon which the alleged cause of action set forth in the complaint herein was based, is not in violation of the provision of Article I, Section 2, Clause 3, of the Constitution of the United States to the effect that "direct taxes shall be apportioned among the several States."

84 Third. The Court erred in holding that Section 2 of said Act of Congress of October 3, 1913, upon which the alleged cause of action set forth in the complaint herein was based, is not in violation of the provision of Article I, Section 9, Clause 4, of the Constitution of the United States, to the effect that "no Capitation, or other direct Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken."

Fourth. The Court erred in holding that the shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by the defendant as stated in the affirmative defense set forth in the amended answer herein constituted income and were subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Fifth. The Court erred in holding that said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein were subject to taxation under Section 2 of said Act of Congress of October 3, 1913.

Sixth. The Court erred in holding that the difference between the market value of said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein and the amount by which the surpluses of The Prairie Oil & Gas Company and The Ohio Oil Company were reduced by reason

85 of the transfer of the pipe line properties to The Prairie Pipe Line Company and The Illinois Pipe Line Company constituted income and was subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States.

Seventh. The Court erred in holding that the difference between the market value of said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein and the amount by which the surpluses of The Prairie Oil & Gas Company and The Ohio Oil Company were reduced by reason of the transfer of the pipe line properties to The Prairie Pipe Line Company and The Illinois Pipe Line Company was subject to taxation under Section 2 of said Act of Congress of October 3, 1913.

Eighth. The Court erred in holding that that proportion of the market value of said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein which the value of the pipe line properties acquired out of the proceeds of the sale of stock and bonds and out of earnings accumulated prior to March 1, 1913, bears to the total market value thereof, constituted income and was subject to taxation within the meaning of the Sixteenth Amendment to the Constitution of the United States.

Ninth. The Court erred in holding that that proportion of the market value of said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein which the value of the pipe line properties acquired out of the proceeds of the sale of stock and bonds and out of earnings
86 accumulated prior to March 1, 1913, bears to the total market value thereof, was subject to taxation under Section 2 of said Act of Congress of October 3, 1913.

Tenth. The Court erred in holding that the difference to the stockholders of a corporation is substantial when property formerly held by that corporation is transferred to a newly organized corporation of which that property constitutes the sole assets and all and only the stock of which is received by such stockholders.

Eleventh. The Court erred in holding that there is a substantial difference between the transfer of the surplus of a corporation to capital account and the issue of a stock dividend on the one hand, and, on the other hand, the transfer by a corporation of a part of its property to a newly organized corporation of which that property constitutes the only assets and the distribution to the stockholders of the original corporation of all and only the shares of stock of the newly organized corporation.

Twelfth. The Court erred in holding that the distribution of said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein did not constitute a true stock dividend within the decisions of the Supreme Court of the United States in *Towne v. Eisner*, 245 U. S. 418, and *Eisner v. Macomber*, 252 U. S. 189.

Thirteenth. The Court erred in holding that the distribution of said shares of stock received by the defendant as stated in the affirmative defense set forth in the amended answer herein did not
87 constitute a dividend in liquidation within the decision of the Supreme Court of the United States in *Lynch v. Turrish*, 247 U. S. 221.

Fourteenth. The Court erred in holding that the control of the pipe line properties was acquired by the stockholders of The Prairie Oil & Gas Company and The Ohio Oil Company within the meaning of the decision of the United States Supreme Court in *Eisner v. Macomber*, 252 U. S. 189.

Fifteenth. The Court erred in holding that the pipe line properties were transferred to the separate use and benefit or the individual ownership of the stockholders within the meaning of the decision of the United States Supreme Court in *Eisner v. Macomber*, 252 U. S. 189.

Dated: September 9, 1921.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Plaintiffs.

37 Wall Street, New York, N. Y.

88 [Endorsed:] L. 24-77. United States District Court, Southern District of New York. United States of America, Plaintiff, against John D. Rockefeller, Defendant. Assignment of Errors. Murray, Prentice & Aldrich, Attorneys for Defendant, 37 Wall Street, New York.

89 District Court of the United States of America for the Southern District of New York, in the Second Circuit.

UNITED STATES OF AMERICA, Plaintiff, Respondent,
against

JOHN D. ROCKEFELLER, Defendant, Appellant.

Bond on Appeal.

Know all men by these presents, That John D. Rockefeller, as principal, and National Surety Company, a corporation under the laws of the State of New York, with its principal place of business at No. 115 Broadway, in the City, County and State of New York, as surety, are held and firmly bound unto the above named United States of America, in the sum of Two Hundred and Fifty (\$250) Dollars to be paid to the said United States of America, for the payment of which well and truly to be made, said principal and surety bind themselves, their heirs, executors, administrators and assigns, jointly and severally, firmly by these presents. Sealed and dated the 9th day of September, 1921.

Whereas, the above named John D. Rockefeller has prosecuted a writ of error to the United States Supreme Court of Washington, D. C., to reverse the judgment rendered in the above entitled suit, by a Judge of the District Court of the United States for the Southern District of New York.

Now, therefore, the condition of this obligation is such, that if the above named John D. Rockefeller shall prosecute said writ to effect, and answer all damages and costs if he fail to make said writ good, then this obligation shall be void, otherwise the same shall be and remain in full force and virtue.

JOHN D. ROCKEFELLER.

NATIONAL SURETY COMPANY,

By H. E. EMMETT,

Resident Vice-President.

Attest:

N. V. TYNAN,

Resident Assistant Secretary.

STATE OF NEW YORK,

County of New York, ss:

On this 10 day of September, 1921, before me personally came the within named John D. Rockefeller to me known, and known to me to be the individual described in and who executed the within bond and he acknowledged that he executed the same.

HARRY P. FISH, [SEAL.]
Notary Public, Westchester Co.

Ctf. filed N. Y. Co. Cl. #233, Reg. 3145.
Commission expires Mar. 30, 1923.

[Endorsed:] L. 24-77. District Court of United States, Southern District of New York. United States of America, Plaintiff Respondent, against John D. Rockefeller, Defendant Appellant. Bond on Appeal. Surety, National Surety Company. I approve of the *written* Bond, and of the sufficiency of the surety thereon. C. M. Hough, U. S. C. J. 9/13/21.

Affidavit, Acknowledgment, and Justification by Guarantee or Surety Company.

STATE OF NEW YORK,

County of New York, ss:

On this 9th day of September, 1921, before me personally came H. E. Emmett, known to me to be the Resident Vice-President of National Surety Company, the corporation described in and which executed the foregoing bond of John D. Rockefeller as surety and who, being by me duly sworn, did depose and say that he resides in the City of New York, State of New York; that he is the Resident Vice-President of said Company, and knows the corporate seal thereof; that the said National Surety Company is duly incorporated under the laws of the State of New York, that said Company has complied with the provisions of the Act of Congress of August 13, 1894, that the seal affixed to the within Bond of John D. Rockefeller is the corporate seal of said National Surety Company, and was thereto affixed by authority of the Board of Directors of said Company, and that he signed his name thereto by like authority as Resident Vice-President of said Company, and that he is acquainted with N. V. Tynan and knows him to be the Resident Assistant Secretary of said Company; and that the signature of said N. V. Tynan subscribed to said Bond is in the genuine handwriting of said N. V. Tynan, and was thereto subscribed by order and authority of said Board of Directors, and in the presence of said deponent; and that the assets of said Company, unencumbered and liable to execution exceed its debts and liabilities of every nature whatsoever, by more than the sum of Ten Million dollars.

H. E. EMMETT,
(Deponent's Signature.)

Signed, sworn to, and acknowledged before me this 9 day of September, 1921.

W. E. FIELDS,
Notary Public, etc.

90

L 24-77.

Writ of Error.

UNITED STATES OF AMERICA:

The President of United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, or some of you, between United States of America, plaintiff, against John D. Rockefeller, defendant, manifest error hath happened, to the great damage of John D. Rockefeller, defendant as aforesaid, We being willing that such error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in its behalf, Do Command You, if judgment be therein given that thereunder your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same to The Supreme Court of the United States, in the City of Washington, District of Columbia, together with this writ, so that you have the same at the said place, on the 8th day of October, 1921, that the record and proceedings aforesaid being inspected, said Supreme Court of the United States may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the Honorable William Howard Taft, Chief Justice of the United States, this 10th day of Sept. in the year of our Lord
91 one thousand nine hundred and twenty-one and of the Independence of the United States the one hundred and forty-sixth.

[SEAL.]

ALEX. GILCHRIST, JR.,
Clerk of the District Court of the United States of America for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed.

J. M. MAYER,
U. S. District Judge.

92 [Endorsed:] L 24-77. United States District Court, Southern District of New York. United States of America, Plaintiff, against John D. Rockefeller, Defendant. Writ of Error. Murray, Prentice & Aldrich, Attorneys for Defendant, 37 Wall Street, New York. Filed Sept. 10th, 1921.

By the Honorable Julius M. Mayer, One of the Judges of the District Court of the United States for the Southern District of New York, in the Second Circuit, to the United States of America, Greeting:

You are hereby cited and admonished to be and appear before the United States Supreme Court to be holden in the City of Washington, on the 8th day of October 1921, pursuant to a writ of error filed in the clerk's office of the District Court of the United States for the Southern District of New York, wherein John D. Rockefeller is plaintiff-in-error and you are defendant-in-error, to show cause, if any there be, why the proceedings and judgment in the said writ of error mentioned, should not be corrected and why speedy justice should not be done in that behalf.

Given under my hand in the Borough of Manhattan, in the City of New York, in the District and Circuit above named, this 10th day of September, in the year of our Lord one thousand nine hundred and twenty-one and of the Independence of the United States the one hundred and forty-sixth.

J. M. MAYER,

*Judge of the District Court of the United
States for the Southern District of
New York, Second Circuit.*

[Endorsed:] United States District Court, Southern District of New York. The United States of America, Plaintiff, against John D. Rockefeller, Defendant. Citation on Appeal. Murray, Prentice & Aldrich, 37 Wall Street, New York.

Stipulation on Appeal Record.

United States District Court, Southern District of New York.

THE UNITED STATES OF AMERICA, Plaintiff,

vs.

JOHN D. ROCKEFELLER, Defendant.

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated — —, — —.

WM. HAYWARD,

U. S. Attorney, Attorney for Plaintiff.
MURRAY, PRENTICE & ALDRICH,
Attorneys for Defendant.

[Endorsed:] United States District Court, Southern District of New York. The United States of America, Plaintiff, vs. John D. Rockefeller, Defendant. Stipulation as to Correctness of Appeal Record.

96 UNITED STATES OF AMERICA,
Southern District of New York, ss:

THE UNITED STATES OF AMERICA, Plaintiff,

vs.

JOHN D. ROCKEFELLER, Defendant.

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby Certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this thirteenth day of September in the year of our Lord one thousand nine hundred and twenty-one and of the Independence of the said United States the one hundred and forty-sixth.

[Seal of the District Court of the United States, Southern District of N. Y.]

ALEX. GILCHRIST, Jr.,
Clerk.

97 [Endorsed:] United States District Court, Southern District of New York. The United States of America, Plaintiff, against John D. Rockefeller, Defendant. Certified Copies of Papers on Appeal. Murray, Prentice & Aldrich, Attorneys for Defendant, 37 Wall Street, New York.

Endorsed on cover: File No. 28,490. S. New York D. C. U. S. Term No. 535. John D. Rockefeller, plaintiff in error, vs. The United States of America. Filed September 15th, 1921. File No. 28,490.

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IN ERROR

TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1921.

No. 536.

THE NEW YORK TRUST COMPANY AND EDITH HALE
HARKNESS, EXECUTORS OF THE LAST WILL AND TES-
TAMENT OF WILLIAM L. HARKNESS, DECEASED, PLAIN-
TIFFS IN ERROR,

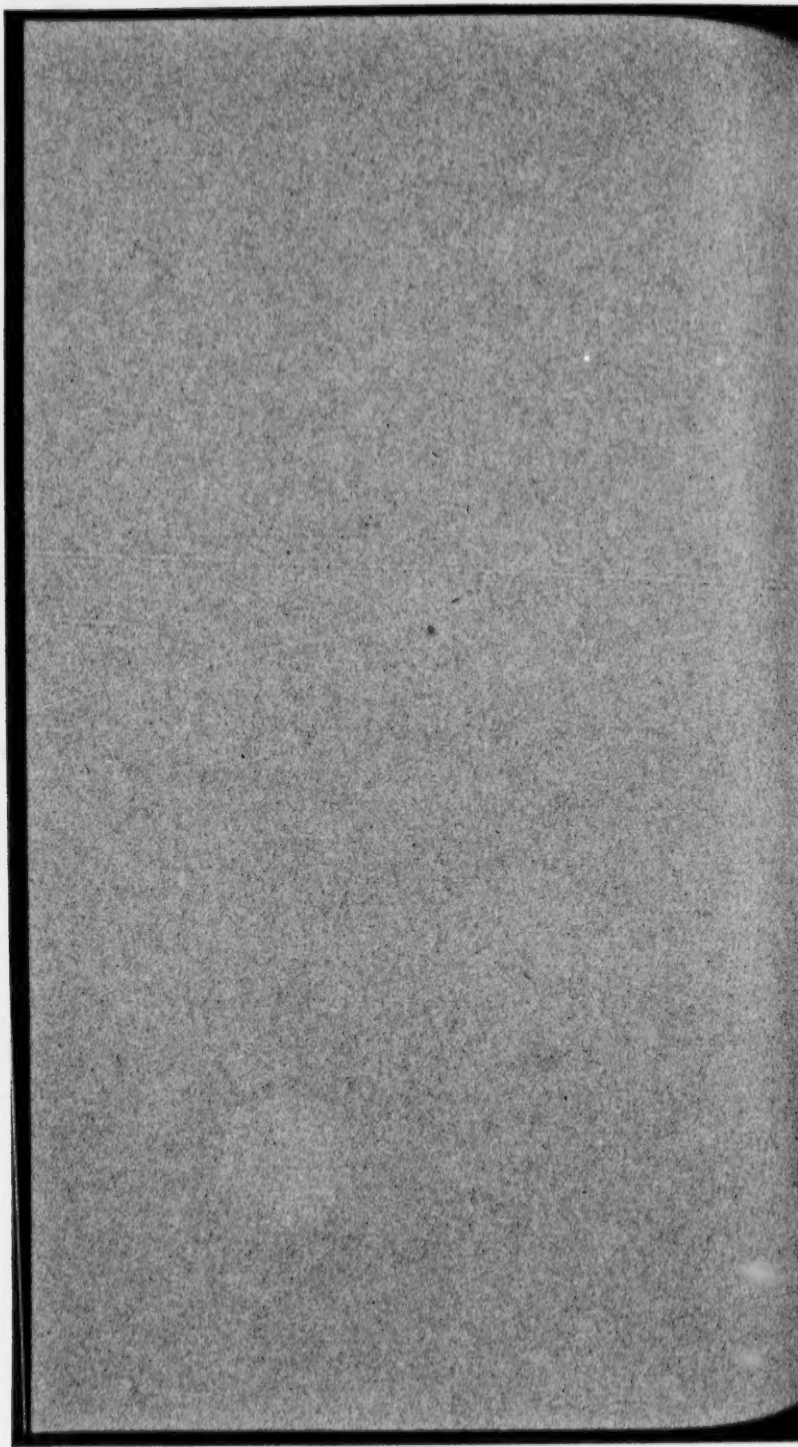
vs.

WILLIAM H. EDWARDS, COLLECTOR OF UNITED STATES
INTERNAL REVENUE FOR THE SECOND DISTRICT OF
NEW YORK.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR
THE SOUTHERN DISTRICT OF NEW YORK.

FILED SEPTEMBER 15, 1921.

(28,491)



(28,491)

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1921.

No. 536.

THE NEW YORK TRUST COMPANY AND EDITH HALE
HARKNESS, EXECUTORS OF THE LAST WILL AND TES-
TAMENT OF WILLIAM L. HARKNESS, DECEASED, PLAIN-
TIFFS IN ERROR,

vs.

WILLIAM H. EDWARDS, COLLECTOR OF UNITED STATES
INTERNAL REVENUE FOR THE SECOND DISTRICT OF
NEW YORK.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR
THE SOUTHERN DISTRICT OF NEW YORK.

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1 United States District Court for the Southern District of New
York.

L 25/19.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Hark-
ness Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of New York, Defendant.

To the above-named defendant:

You are hereby summoned to answer the complaint in this action,
and to serve a copy of your answer on the plaintiffs' attorney within
twenty days after the service of this summons, exclusive of the day
of service; and in case of your failure to appear, or answer, judg-
ment will be taken against you by default for the relief demanded
in the complaint.

Witness the Honorable Learned Hand, Judge of the District
Court of the United States for the Southern District of New York,
at the City of New York, this 1st day of March, in the year one
thousand nine hundred and twenty one.

[SEAL.]

ALEX. GILCHRIST, JR.,

Clerk.

MURRAY, PRENTICE & ALDRICH,

Plaintiffs' Attorney.

Office and Postoffice Address 37 Wall St., Borough of Manhattan,
New York City.

2 U. S. District Court, Southern District of New York.

L 25/19.

THE NEW YORK TRUST COMPANY et al., Plaintiffs,

versus

WILLIAM H. EDWARDS, Collector of Internal Revenue for the Sec-
ond District of New York, Defendant.

Notice of Appearance and Demand.

You will please take notice that I am retained by, and appear as
attorney for, the Defendant in this action, and demand service of
all papers in this action upon me, at my office in the United States

2

N. Y. TRUST CO. ET AL. VS. W. H. EDWARDS, ETC.

Court and Post Office Building, in the City of New York, Borough of Manhattan.

Yours,

FRANCIS G. CAFFEY,
United States Attorney, Attorney for Defendant.

New York, March 21, 1921.

To Murray, Prentice & Howland,
37 Wall Street,
Attorney- for Plaintiffs.

3

[Endorsed:] U. S. District Court, Southern District of New York. The New York Trust Co. et al., plaintiffs, versus Wm. H. Edwards, Collector of Internal Revenue, etc., defendant. Notice of Appearance. Francis G. Caffey, United States Attorney, Attorney for Defendant. Due service of a copy of the within Notice is hereby admitted. Dated the 21st day of March, 1921. Murray, Prentice and Aldrich, Plaintiffs' Attorney-. To Murray, Prentice & Howland, 37 Wall Street, Plaintiffs' Attorney-.

4

United States District Court, Southern District of New York.

L 25/19.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Harkness, Deceased, Plaintiffs,
against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue for the Second District of the State of New York, Defendant.

Amended Complaint.

Murray, Prentice & Aldrich,
Attorneys for Plaintiffs,
37 Wall Street, Manhattan, New York.

5

United States District Court, Southern District of New York

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Harkness, Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue for the Second District of the State of New York, Defendant.

The plaintiffs for their amended complaint herein, by Murray, Prentice & Aldrich, their attorneys, allege as follows:

I. That at all the times hereinafter mentioned the plaintiff The New York Trust Company was and now is a corporation duly organized and existing under the laws of the State of New York, having a principal office in the City and County of New York, and the plaintiff Edith Hale Harkness was and now is a citizen of the State of New York and a resident of the City, County and State of New York. That William L. Harkness, plaintiffs' testator, was at all the times hereinafter mentioned up to the 10th day of May, 1919, a citizen of the State of New York, having an office for the transaction of his business in the Second Internal Revenue District of the State of New York. That said William L. Harkness died on May 10, 1919. That on May 23, 1919, his last will and testament was duly admitted to probate by the Surrogates' Court of the County of New York, and that on May 26, 1919, letters testamentary thereon were duly issued to the plaintiffs herein, who thereupon duly qualified as executors of his said last will and testament and have continued to act and are now acting as executors thereof.

II. That since on or about April 9, 1917, the defendant has been and now is the Collector of United States Internal Revenue for the Second District of the State of New York.

III. That during the year 1914, The Prairie Oil & Gas Company was a corporation duly organized and existing under and by virtue of the laws of the State of Kansas, and engaged in producing, purchasing and selling crude petroleum and transporting the same by pipe lines owned by it in the States of Kansas and Oklahoma and elsewhere. That at all the times hereinafter mentioned, The Prairie Oil & Gas Company had an authorized capital stock, all of which was issued and outstanding, of Eighteen million dollars (\$18,000,000) divided into One hundred and eighty thousand (180,000) shares of the par value of One hundred dollars (\$100) each.

IV. That in June, 1914, it was judicially determined by the Supreme Court of the United States that The Prairie Oil & Gas Company was required to operate its pipe lines as a common carrier of oil in interstate commerce and as such was subject to the supervision of the Interstate Commerce Commission of the United States.

That by Act of Congress, approved September 26, 1914, practically all of the business of The Prairie Oil & Gas Company, other than the operation of its pipe lines as a common carrier of oil in interstate commerce, was made subject to the supervision of the Federal Trade Commission.

V. That in order to avoid the conflict of Federal authority in the regulation of the business of The Prairie Oil & Gas Company it was upon advice of counsel, considered advisable that the pipe line property be owned and operated by a corporation other than The Prairie Oil & Gas Company. That The Prairie Oil & Gas Company could not under its charter and the statutes of the State of Kansas acquire or hold the stock of a corporation owning and operating the pipe line property. That the stockholders of The Prairie Oil & Gas Company

at the regular annual meeting held on December 8, 1914, adopted the preambles and resolution, a copy of which is set forth in "Exhibit A" annexed hereto and made a part hereof and authorized the organization of a corporation for the purpose of owning and operating the pipe line property.

VI. That thereafter and on or about December 8, 1914, pursuant to said resolution, the Board of Directors of The Prairie Oil & Gas Company caused a corporation to be organized under the laws of the State of Kansas, under the name of The Prairie Pipe Line Company with an authorized capital stock of Twenty-seven million dollars (\$27,000,000) divided into two hundred and seventy thousand (270,000) shares of the par value of one hundred dollars (\$100) each, and having authority under its charter to purchase, own and operate a system of pipe lines for the gathering and transmitting of oil, and The Prairie Pipe Line Company, pursuant to resolutions of its Board of Directors, a copy of which is set forth in "Exhibit B" annexed hereto and made a part hereof, offered to acquire the pipe line property owned by The Prairie Oil & Gas Company in consideration of the delivery of all of its capital stock. That said offer of The Prairie Pipe Line Company was accepted by The Prairie Oil & Gas Company at a meeting of its Board of Directors held on January 21, 1915, by the adoption of the preambles and resolution, a copy of which is set forth in "Exhibit C" annexed hereto and made a part hereof.

VII. That thereafter pursuant to said resolutions of the Board of Directors of The Prairie Oil & Gas Company and resolutions of the Board of Directors of The Prairie Pipe Line Company, a copy of which is set forth in "Exhibit D" annexed hereto and made a part hereof, there was executed an agreement dated January 21, 1915, a copy of which is set forth in "Exhibit E" annexed hereto and made a part hereof, which provided for the transfer of the pipe line property to The Prairie Pipe Line Company in consideration of the issue and delivery of all of its capital stock to The Prairie Oil & Gas Company, and which further provided that the pipe line property should include land, rights of way, equipment and working stocks of oil and that if the actual cost of the pipe line property to The Prairie Oil & Gas Company as shown in its investment records should not equal the sum of Twenty-seven million dollars (\$27,000,000), The Prairie Oil & Gas Company should pay to The Prairie Pipe Line Company such sum as might be necessary, when added to the value of such property, to equal the sum of Twenty-seven million dollars (\$27,000,000), and that if the cost of such property to The Prairie Oil & Gas Company as so determined should be in excess of the sum of Twenty-seven million dollars (\$27,000,000) The Prairie Pipe Line Company should pay to The Prairie Oil & Gas Company such excess in cash.

VIII. That the Board of Directors of The Prairie Oil & Gas Company, at a meeting held on January 21, 1915, duly adopted the preambles and resolutions, a copy of which is set forth in "Exhibit F"

annexed hereto and made a part hereof, providing for the issue and distribution to the stockholders of The Prairie Oil & Gas Company, pro rata, of all of the capital stock of The Prairie Pipe Line Company.

IX. That on or about February 1, 1915, the pipe line property was transferred to The Prairie Pipe Line Company and there was paid to it by The Prairie Oil & Gas Company the sum of One hundred and forty-one thousand, three hundred and sixty dollars and thirteen cents (\$141,360.13) in cash and The Prairie Pipe Line Company in accordance with said agreement between The Prairie Oil & Gas Company and The Prairie Pipe Line Company dated January 21, 1915, issued and caused to be distributed to each stockholder of The Prairie Oil & Gas Company a certificate or certificates representing a number of shares of the capital stock of The Prairie Pipe Line Company equal to one and one-half ($1\frac{1}{2}$) times the number of shares of the capital stock of The Prairie Oil & Gas Company standing in his or her name on the stock books of The Prairie Oil & Gas Company on February 9, 1915.

X. That upon the transfer of the pipe line property to The Prairie Pipe Line Company the pipe line property was taken up as an asset of The Prairie Pipe Line Company and eliminated as an asset of The Prairie Oil & Gas Company. That the shares of stock
10 of The Prairie Pipe Line Company were at no time entered as an asset of The Prairie Oil & Gas Company. That on January 31, 1915, the following voucher entries were made:

	Debit.	Credit.
"The Prairie Pipe Line Company, Separation Account"	\$27,000,000.00	
Being the value of assets sold at close of business January 31st, 1915.		
The Prairie Pipe Line Company.		\$141,360.13
Being the difference between \$27,000,000.00 and \$26,858,638- .87, the book value of the prop- erty sold to The Prairie Pipe Line Company.		
NOTE.—Under the agreement date January 21st, between The Prairie Oil & Gas Co. and The Prairie Pipe Line Company, it was agreed that in the event that the property sold to The Prairie Pipe Line Company did not equal the sum of \$27,000,000.00, the difference between the ascertained value and \$27,000,000.00 was to be paid by The Prairie Oil & Gas Company to The Prairie Pipe Line Company in cash.		
Investment:		
Operated property, consisting of Pipe Lines, tanks, etc.		25,292,378.91
Suspended Investment.		25,398.91
Crude Oil Sales Account:		
Crude Oil in working tanks	2,363,890.35 bbls.	
Less worthless	292,453.10 bbls.	
Merchantable Oil	2,071,437.27 bbls. @.743519	1,540,152.95
Empty Sacks Account.		568.60
Prest-O-Lite Cylinder Account		20.50
Ammonia Cylinder Account.		120.00
	\$27,000,000.00	\$27,000,000.00

11 That the practice of The Prairie Oil & Gas Company was to charge to dividend account the amount of dividends paid and at the end of the year to charge off to profit and loss the amount of dividends paid during the year. That no entry was made in dividend account of The Prairie Oil & Gas Company in connection with this transaction. That there was charged off to profit and loss the sum of Twenty-seven million dollars (\$27,000,000). That on January 31, 1915, the following voucher entries were made:

	Debit.	Credit.
The Prairie Pipe Line Company		
Separation Account		\$27,000,000.00
Profit and Loss	\$27,000,000.00	

To close "The Prairie Pipe Line Separation Account" into Profit and Loss, being amount of assets sold The Prairie Pipe Line Company at date of organization of latter company.

That the surplus of The Prairie Oil & Gas Company amounted to the sum of Forty million, three hundred sixty-seven thousand, twenty-nine and 69/100 dollars (\$40,367,029.69) on March 1, 1913, the sum of Sixty million, seventy-one thousand, nine hundred twenty-four and 54/100 dollars (\$60,071,924.54) on January 31, 1915, immediately before the transfer of the pipe line property, and the sum of Thirty-eight million, eight hundred fifty-one thousand, nine hundred seven and 06/100 dollars (\$38,851,907.06) on February 1, 1915, immediately after the completion of the transaction hereinbefore set forth. That on January 31, 1915, the following voucher entry was made:

	Debit.	Credit.
Depreciation on Property	\$5,784,992.51	
Profit and Loss		\$5,784,992.51

That all of the foregoing voucher entries were subsequently carried into the ledger.

12 XI. That approximately seventy-five per cent (75%) of the pipe line property transferred to The Prairie Pipe Line Company had been acquired by the Prairie Oil & Gas Company prior to March 1, 1913. That during the period of time prior to March 1, 1913, when such pipe line property was acquired, The Prairie Oil & Gas Company had in its treasury funds composed in part of the proceeds of the sale of its stock and bonds then outstanding and in part of earnings, and the money out of which the property in question was acquired was paid from such funds. That if the pipe line property owned by The Prairie Oil & Gas Company on March 1, 1913, and which was transferred to The Prairie Pipe Line Company had any greater value at the time of such transfer than it had on March 1, 1913, the amount of the increase in value was not equivalent to the par value of the shares of stock of The Prairie

Pipe Line Company distributed to the stockholders of The Prairie Oil & Gas Company.

XII. That after the transfer of the pipe line property of The Prairie Oil & Gas Company to The Prairie Pipe Line Company and the issue of the stock of The Prairie Pipe Line Company to the stockholders of The Prairie Oil & Gas Company, the asset or book value of the capital stock of The Prairie Oil & Gas Company was reduced to the extent of the asset or book value of the pipe line property, and the asset or book value of each share of the capital stock of The Prairie Oil & Gas Company was proportionately reduced.

13 XIII. That prior to the transfer of the pipe line property to The Prairie Pipe Line Company, sales of stock of The Prairie Oil & Gas Company had been made in the open market as follows:

January 4, 1915, at 464.

February 1, 1915, at 469.

February 4, 1915, at 465.

That after the transfer of the pipe line property, sales of stock of The Prairie Oil & Gas Company were made in the open market as follows:

February 10, 1915, at 219.

February 24, 1915, at 212.

March 1, 1915, at 224.

That sales of stock of The Prairie Pipe Line Company were made in the open market as follows:

February 10, 1915, at 146.

February 24, 1915, at 138.

March 1, 1915, at 150.

XIV. That the value of the shares of the capital stock of The Prairie Oil & Gas Company owned by each stockholder, including the plaintiffs' testator, immediately prior to the transfer of the pipe line property to The Prairie Pipe Line Company, was substantially the same as the value of the shares of the capital stock of The Prairie Oil & Gas Company owned by each stockholder, including plaintiffs' testator, plus the value of the shares of the capital stock of The Prairie Pipe Line Company received by each stockholder of The Prairie Oil & Gas Company, including plaintiffs' testator, immediately after such transfer.

14 XV. That on March 1, 1913, and on February 9, 1915, William L. Harkness, plaintiffs' testator, was the owner of One thousand seven hundred and eight (1,708) shares of the capital stock of The Prairie Oil & Gas Company and received on or about March 25, 1915, under the distribution referred to in Paragraph IX, certificates representing Two thousand five hundred and sixty-two (2,562) shares of the capital stock of The Prairie Pipe Line Company. That none of said shares of the capital stock

of The Prairie Pipe Line Company has been sold by plaintiffs' testator or by plaintiffs.

XVI. That during the year 1914 The Ohio Oil Company was a corporation duly organized and existing under and by virtue of the laws of the State of Ohio and engaged in producing and manufacturing petroleum and mineral oil and transporting oil and petroleum and its products by pipe lines owned by it in the States of Ohio, Indiana, Illinois and Pennsylvania. That at all the times hereinafter mentioned The Ohio Oil Company had an authorized capital stock, all of which was issued and outstanding, of Fifteen million dollars (\$15,000,000) divided into Six hundred thousand (600,000) shares of the par value of Twenty-five dollars (\$25) each.

XVII. That in June, 1914, it was judicially determined by the Supreme Court of the United States that The Ohio Oil Company was required to operate its pipe lines as a common carrier of oil in interstate commerce and as such was subject to the supervision of the Interstate Commerce Commission of the United States. That by Act of Congress approved September 26, 1914, practically all of the business of The Ohio Oil Company other than the operation of its pipe lines as a common carrier of oil in interstate commerce was made subject to the supervision of the Federal Trade Commission. That the gross receipts of the entire business of The Ohio Oil Company was subject to a tax of 4% per annum, imposed by Section 5487 of the Ohio General Code, upon the gross receipts of companies engaged in transporting oil by pipe lines, although a large part of the gross receipts of The Ohio Oil Company was derived from business other than the business of transporting oil by pipe lines.

XVIII. That in order to avoid the conflict of Federal authority in the regulation of the business of The Ohio Oil Company and to avoid the annual assessment of said 4% tax upon the gross receipts of the business of The Ohio Oil Company other than the business of transporting oil by pipe lines, it was upon advice of counsel considered advisable that the pipe line property be owned and operated by a corporation other than The Ohio Oil Company and that the stock of the corporation owning and operating the pipe line property should not be permanently held by The Ohio Oil Company. That on or about November 27, 1914 the Board of Directors of The Ohio Oil Company caused a corporation to be organized under the laws of the State of Ohio under the name of The Illinois Pipe Line Company, with an authorized capital stock of Twenty million dollars (\$20,000,000) and having authority under its charter to purchase, own and operate a system of pipe lines for the gathering and transmitting of oil.

XIX. That the Board of Directors of The Ohio Oil Company, at a meeting held on November 30, 1914, a copy of the minutes of

16 which is set forth in "Exhibit G" annexed hereto and made a part hereof, authorized a subscription on behalf of The Ohio Oil Company to One hundred ninety-nine thousand nine hundred and ninety-five (199,995) shares of the capital stock of The Illinois Pipe Line Company.

XX. That pursuant to the preamble and resolution adopted at a meeting of stockholders held on November 30, 1914, a copy of which is set forth in "Exhibit H" annexed hereto and made a part hereof, and the preamble and resolution adopted at a meeting of the Board of Directors held on November 30, 1914, a copy of which is set forth in "Exhibit I" annexed hereto and made a part hereof, The Illinois Pipe Line Company offered, by a certain instrument in writing dated November 30, 1914, a copy of which is set forth in "Exhibit J" annexed hereto and made a part hereof, to acquire the pipe line property owned by The Ohio Oil Company and Two hundred thousand dollars (\$200,000) in cash, and in consideration to issue all of its capital stock to The Ohio Oil Company, or to pay to The Ohio Oil Company Twenty million dollars (\$20,000,000) in cash or in cash and notes, as might be determined between The Ohio Oil Company and The Illinois Pipe Line Company.

XXI. That the Board of Directors of The Ohio Oil Company, at a meeting held on December 1, 1914, duly adopted the preambles and resolution, a copy of which is set forth in "Exhibit K" annexed hereto and made a part hereof, calling a special meeting of the stockholders of The Ohio Oil Company to be held on December 21, 1914.

17 XXII. That said offer of The Illinois Pipe Line Company was accepted by the stockholders of The Ohio Oil Company at a meeting held on December 21, 1914, by the adoption of the preamble and resolutions, a copy of which is set forth in "Exhibit L" annexed hereto and made a part hereof.

XXIII. That between November 30, 1914, and January 1, 1915, it was determined between The Ohio Oil Company and The Illinois Pipe Line Company that in consideration of the transfer of the pipe line property The Illinois Pipe Line Company should issue all of its capital stock to The Ohio Oil Company, and should not pay the sum of Twenty Million Dollars (\$20,000,000) in cash or in cash and notes.

XXIV. That the Board of Directors of The Ohio Oil Company at a meeting held on December 21, 1914, provided for the effectuation of the transfer of the pipe line property to The Illinois Pipe Line Company and the distribution of the stock of The Illinois Pipe Line Company among the stockholders of The Ohio Oil Company, *pro rata*, by the adoption of the preambles and resolutions, a copy of which is set forth in "Exhibit M" annexed hereto and made a part hereof.

XXV. That on or about January 1, 1915, the pipe line property was transferred to The Illinois Pipe Line Company and The Illinois Pipe Line Company issued to The Ohio Oil Company a certificate representing Two hundred thousand (200,000) shares of its capital stock, the receipt for which is set forth in "Exhibit N" annexed hereto and made a part hereof, and The Ohio Oil Company surrendered said certificate to The Illinois Pipe Line Company with instructions to cancel the same and issue new certificates to the stockholders of

The Ohio Oil Company so that each stockholder of The Ohio Oil Company should receive a certificate or certificates representing a number of shares of the capital stock of The Illinois Pipe Line Company equal to one-third ($1/3$) the number of shares of the capital stock of The Ohio Oil Company standing in his or her name on the stock books of The Ohio Oil Company on January 2, 1915, and pursuant to such instructions said new certificates were issued and distributed.

XXVI. That upon the transfer of the pipe line property to The Illinois Pipe Line Company the pipe line property was taken up as an asset of The Illinois Pipe Line Company and eliminated as an asset of The Ohio Oil Company. That the shares of stock of The Illinois Pipe Line Company were entered as an asset of The Ohio Oil Company. That the practice of The Ohio Oil Company was to charge to dividend account the amount of dividends paid and at the end of the year to charge off to profit and loss the amount of dividends paid during the year. That no entry was made in dividend account of The Ohio Oil Company in connection with this transaction. That there was charged off to profit and loss the sum of Twenty million dollars (\$20,000,000). That the following voucher entries were made:

Entry Dated January 1, 1915.

The Pipe Line Property of this company, located in the States of Illinois, Indiana, Ohio and Pennsylvania, consisting of complete Trunk Lines and Gathering Lines systems, together with the loose material appertaining thereto and \$200,000 in Cash, having been sold to the Illinois Pipe Line Company pursuant to action taken at meeting of Stockholders and meeting of Directors held on December 21, 1914, for 200,000 shares of the par value of \$100 each of the Capital Stock of The Illinois Pipe Line Company, the following entries are made in accordance therewith.

19	Stock of The Illinois Pipe		
	Line Co.	\$20,000,000.00	
	Pipe Line Investment.....		\$15,429,941.62
	Material & Merchandise.....		18,437.59
	Cash		200,000.00
	Profit & Loss		4,351,620.79
		<hr/>	<hr/>
		20,000,000.00	20,000,000.00

Entry Dated January 1, 1915.

Entry to restore the Depreciation Reserve which had been established in the Books of this Company with respect to its Pipe Line Property, and which Property has been sold.

Depreciation on Property	5,467,075.52	
Profit & Loss		5,467,075.52

Entry Dated January 31, 1915.

The Directors of this Company having voted at meeting held on December 21, 1914, to distribute, pro rata, to stockholders of this company of record January 2, 1915, the Capital Stock of The Illinois Pipe Line Company, the following entry is made in accordance therewith.

Profit & Loss (Dividend)	20,000,000.00	
Stock of The Illinois Pipe Line Co.		20,000,000.00

That all of the foregoing voucher entries were subsequently carried into the ledger.

That the surplus of The Ohio Oil Company amounted to the sum of Fifty-four million, twenty-four thousand, seven hundred forty-six and 63/100 dollars (\$54,024,746.63) on March 1, 1913, the sum of Sixty-eight million, eight hundred forty-nine thousand, four hundred twenty-seven and 49/100 dollars (\$68,849,427.49) on December 31, 1914, immediately before the transfer of the pipe line property, and the sum of Fifty-eight million, six hundred fifty-eight thousand, fifteen and 35/100 dollars (\$58,658,015.35) on January 31, 1915, after the completion of the transaction hereinbefore set forth.

XXVII. That on March 1, 1913, The Ohio Oil Company owned and had paid for all or a substantial percentage of the pipe line property which was subsequently transferred to The Illinois Pipe Line Company. That if the pipe line property owned by The Ohio Oil Company on March 1, 1913, and which was transferred to The Illinois Pipe Line Company had any greater value at the time of its transfer than on March 1, 1913, the amount of the increase in value was not equivalent to the par value of the stock of The Illinois Pipe Line Company distributed to the stockholders of The Ohio Oil Company.

XXVIII. That after the transfer of the pipe line property of The Ohio Oil Company to The Illinois Pipe Line Company, and the distribution of the stock of The Illinois Pipe Line Company to the stockholders of The Ohio Oil Company, the asset or book value of the capital stock of The Ohio Oil Company was reduced to the extent of the asset or book value of the pipe line property and the asset or book value of each share of the capital stock of The Ohio Oil Company was proportionately reduced.

XXIX. That prior to the transfer of the pipe line property to The Illinois Pipe Line Company sales of stock of The Ohio Oil Company had been made in the open market as follows:

December 1, 1914, at 187.
December 26, 1914, at 188.
December 30, 1914, at 186.

That after the transfer of the pipe line property sales of stock of The Ohio Oil Company were made in the open market as follows:

January 2, 1915, at 143.
January 16, 1915, at 142.
February 3, 1915, at 131.

21 That sales of stock of The Illinois Pipe Line Company were made in the open market as follows:

January 2, 1915, at 127.
January 16, 1915, at 141.
February 3, 1915, at 130.

XXX. That the value of the shares of the capital stock of The Ohio Oil Company owned by each stockholder, including plaintiffs' testator, immediately prior to the transfer of the pipe line property to The Illinois Pipe Line Company was substantially the same as the value of the shares of the capital stock of The Ohio Oil Company owned by each stockholder, including plaintiffs' testator, plus the value of the shares of the capital stock of The Illinois Pipe Line Company received by each stockholder of The Ohio Oil Company, including plaintiffs' testator, immediately after such transfer.

XXXI. That on March 1, 1913, and on January 1, 1915, William L. Harkness, plaintiffs' testator, was the owner of Eight thousand five hundred and forty-one (8,541) shares of the capital stock of The Ohio Oil Company and received on or about February 4, 1915, under the distribution referred to in Paragraph XXV, certificates representing Two thousand, eight hundred and forty-seven (2,847) shares of the capital stock of The Illinois Pipe Line Company. That none of said shares of the capital stock of The Illinois Pipe Line Company has been sold by plaintiffs' testator or by plaintiffs.

XXXII. That in accordance with the provisions of the Income Tax Law, being Section 2 of an Act of Congress of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes," the plaintiffs' testator in the year 1915 duly filed his return of income received during the year 1915 and did not include therein as income any part of the value of said shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by him during the year 1915, as aforesaid. That thereafter the Commissioner of Internal Revenue duly caused an examination of said return to be made, and that on or about the 21st day of May, 1917, the

supervising revenue agent in charge of said investigation duly reported that certain securities and property received by the plaintiffs' testator, including said shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by him as aforesaid, constituted taxable income for the year 1915, and should have been included in said return.

XXXIII. That thereafter and on or about August 6, 1917, the defendant, as Collector of Internal Revenue for the Second District of the State of New York, claiming to act in pursuance of the provisions of said Section 2 of said Act of Congress of October 3, 1913, demanded of the plaintiffs' testator the sum of Thirty-six thousand, one hundred forty-three dollars and sixty-six cents (\$36,143.66) as an additional income tax for the year 1915, which defendant claimed to be due and payable by him as an additional income tax for the year 1915. That included in the sum thus demanded as an additional income tax was the sum of Thirty-one thousand, three hundred ninety-eight dollars and thirty-four cents (\$31,398.34), which defendant claimed to be due and payable as an income tax
23 imposed upon the sum of Five hundred forty thousand, nine hundred dollars (\$540,900), being the equivalent of the par value of said 2,562 shares of stock of The Prairie Pipe Line Company and said 2,847 shares of stock of The Illinois Pipe Line Company received by the plaintiffs' testator in the year 1915 as aforesaid. That the defendant threatened to enforce the payment of said tax together with penalties and interest as provided in said Section 2 of said Act of Congress of October 3, 1913, and thereupon the plaintiffs' testator, solely to avoid the imposition of penalties and interest and the collection thereof, and under compulsion, duress and coercion, paid to the defendant, as such Collector, on or about the 16th day of August, 1917, the sum of Thirty-six thousand, one hundred forty-three dollars and sixty-six cents (\$36,143.66), of which sum the sum of Thirty-one thousand, three hundred ninety-eight dollars and thirty-four cents (\$31,398.34) represented the alleged tax imposed on the par value of said shares of stock of The Prairie Pipe Line Company and said shares of stock of The Illinois Pipe Line Company received by the plaintiffs' testator as aforesaid, but said payment was made under protest, and at the same time the plaintiffs' testator protested in writing that no tax was due from him on account of, or on account of the receipt, of said shares of stock or any thereof, and that the defendant was without authority to exact and collect the same or any part thereof, and that the plaintiffs' testator paid the same under duress and compulsion.

XXXIV. That thereafter the plaintiffs' testator duly took an appeal to the Commissioner of Internal Revenue and demanded
24 repayment and refund of the said alleged tax in accordance with the law and the Regulations and Rules of the Treasury Department. That said appeal was duly perfected and filed with the Commissioner of Internal Revenue on or about the 10th day of November, 1917, and that said appeal was disallowed by said Commissioner of Internal Revenue on or about April 22, 1919.

XXXV. That thereafter and on or about June 30, 1919, the defendant, as Collector of United States Internal Revenue for the Second District of New York, claiming to act in pursuance of the provisions of said Section 2 of said Act of Congress of October 3, 1913, demanded of plaintiffs the sum of Thirteen thousand, fifteen dollars and fifty-seven cents (\$13,015.57), which defendant claimed to be due and payable by them, as executors under the last will and testament of William L. Harkness, as a further additional income tax imposed upon the sum of Two hundred sixteen thousand, nine hundred twenty-seven dollars (\$216,927), being the difference between the alleged market value at the date of receipt and the par value of said shares of stock of The Prairie Pipe Line Company and said shares of stock of The Illinois Pipe Line Company received by the plaintiffs' testator in the year 1915 as aforesaid. That the defendant threatened to enforce the payment of said tax together with penalties and interest as provided in said Section 2 of said Act of Congress of October 3, 1913, and thereupon the plaintiffs, solely to avoid the imposition of penalties and interest and the collection thereof, and under compulsion and duress and coercion, paid to the defendant, as such Collector, on or about the 24th day of November, 1919, the sum of Thirteen thousand, fifteen dollars and fifty-seven cents (\$13,015.57), representing the alleged tax imposed on the difference between the market value at the date of receipt and the par value of said shares of stock of The Prairie Pipe Line Company and said shares of stock of The Illinois Pipe Line Company received by plaintiffs' testator as aforesaid, but said payment was made under protest, and at the same time the plaintiffs protested in writing that no tax was due from them on account of, or on account of the receipt of, said shares of stock or any thereof, and that the defendant was without authority to exact and collect the same or any part thereof, and that the plaintiffs paid the same under duress and compulsion.

XXXVI. That thereafter the plaintiffs duly took an appeal to the Commissioner of Internal Revenue and demanded repayment and refund of the said alleged tax in accordance with the law and the Regulations and Rules of the Treasury Department. That said appeal was duly perfected and filed with the Commissioner of Internal Revenue on or about the 25th day of March, 1920, and that more than six months have elapsed since the taking and perfecting of said appeal, but said Commissioner of Internal Revenue has failed and neglected to decide the same and the said appeal has not been decided or determined.

XXXVII. That neither under Section 2 of said Act of Congress of October 3, 1913, nor under any other law or statute of the United States, did the distribution of said shares of stock of The Prairie Pipe Line Company and said shares of stock of The Illinois Pipe Line Company to the plaintiffs' testator as aforesaid constitute a dividend, nor did the receipt thereof by the plaintiffs' testator constitute the receipt of a dividend or taxable income in any form, and no tax was due or has become due to the

United States Government or to the defendant as Collector of United States Internal Revenue for the Second District of New York on said shares of stock received by the plaintiffs' testator as aforesaid, or any of them, or any part of the value thereof, or on account of the receipt of said shares of stock or any thereof, and that said sums of Thirty-one thousand, three hundred ninety-eight dollars and thirty-four cents (\$31,398.34) and Thirteen thousand, fifteen dollars and fifty-seven cents (\$13,015.57), being the amounts of the alleged taxes paid as aforesaid, were illegally and without warrant or authority of law demanded and collected by the defendant from the plaintiffs' testator and from the plaintiffs.

XXXVIII. That the Act of Congress under which said sums of Thirty-one thousand, three hundred ninety-eight dollars and thirty-four cents (\$31,398.34) and Thirteen thousand, fifteen dollars and fifty-seven cents (\$13,015.57) were levied on the value of said shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company, or on account of the receipt thereof, and the payment of said sums compelled, to wit: Section 2 of an Act of Congress of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes," is invalid and void in so far as the same may be asserted to confer power to make such levies or to compel such payments, because in violation of the provision of Article I, Section 2, Clause 3, of the Constitution of the United States, to the effect that "direct Taxes shall be apportioned among the several States," and of the
27 provision of Article I, Section 9, Clause 4 thereof, to the effect that "no Capitation, or other direct Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken," and neither said shares of stock of The Prairie Pipe Line Company nor said shares of stock of The Illinois Pipe Line Company received by the plaintiffs' testator as aforesaid, nor any of them, nor any part of the value thereof, constituted income or was subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." And plaintiffs hereby draw in question the constitutionality of the said Act of Congress and of all of the provisions thereof assumed or asserted to authorize the said levies and the enforcement of the payment thereof.

XXXIX. That no part of said sums of Thirty-one thousand, three hundred and ninety-eight dollars and thirty-four cents (\$31,398.34) and Thirteen thousand, fifteen dollars and fifty-seven cents (\$13,015.57) has been repaid to the plaintiffs' testator or to the plaintiffs, and that the whole amount thereof with interest on \$31,398.34 from the 16th day of August, 1917, and on \$13,015.57 from the 24th day of November, 1919, remains due and owing from the defendant to the plaintiffs.

XL. That this is a suit of a civil nature at common law which arises under the Constitution and Laws of the United States and under the Laws of the United States providing for internal revenue.

Wherefore, plaintiffs demand judgment against the defendant for the sum of Forty-four thousand, four hundred thirteen dollars and ninety-one cents (\$44,413.91), with interest on Thirty-one thousand, three hundred ninety-eight dollars and thirty-four cents (\$31,398.34) from the 16th day of August, 1917, and on Thirteen thousand, fifteen dollars and fifty-seven cents (\$13,015.57) from the 34th day of November, 1919, together with the costs and disbursements of this action.

MURRAY, PRENTICE & ALDRICH,
Attorneys for the Plaintiffs.

37 Wall Street, Manhattan, New York.

STATE OF NEW YORK,

County of New York, ss:

George Welwood Murray, being duly sworn, deposes and says:

I am a member of the firm of Murray, Prentice & Aldrich, the attorneys for the plaintiffs herein, and have had charge of this case. I know the contents of the foregoing amended complaint, and the same is true of my own knowledge except as to the matters therein stated to be alleged upon information and belief, and as to those matters I believe it to be true.

That the sources of my information and the grounds of my belief are information obtained from the officers of The Prairie Oil & Gas Company and The Ohio Oil Company, the books and papers of the plaintiffs' testator and of the plaintiffs as executors, and the communications addressed to the plaintiffs' testator and the plaintiffs as executors by the Commissioner of Internal Revenue and the Collector of Internal Revenue for the Third District of the State of New York, and other correspondence, papers and documents.

GEO. WELWOOD MURRAY.

Sworn to before me this 30th day of June, 1921.

TALBOT M. MALCOLM,
Notary Public, New York County.

Clerk's No. 514, Register's No. 2472.

Commission expires March 30, 1922.

EXHIBIT A.

Whereas, It has been determined in the United States Supreme Court, by opinion handed down on the twenty-second day of June, 1914, that The Prairie Oil & Gas Company is required to operate its pipe lines as a common carrier of oil in interstate commerce, and

as such is subject to the supervision, regulation and control of the Interstate Commerce Commission; and

Whereas, The Prairie Oil & Gas Company is engaged almost wholly in such business as is interstate commerce according to law; and

Whereas, By Act of Congress, approved on the twenty-sixth day of September, 1914, practically all of the business of this company, aside from the transportation of oil in interstate commerce by means of pipe lines, is subjected to the supervision and regulation of the Federal Trade Commission; and

Whereas, By reason of the foregoing, it is considered by the stockholders of The Prairie Oil & Gas Company advisable that the branches of this company's business, which are subject to the supervision and regulation of the Interstate Commerce Commission, be separated in fact from the business subjected to the supervision and control of the Federal Trade Commission; and

Whereas, The said stockholders are advised and believe that this end can be best attained by and through the organization of a corporation which shall take over all the properties of The
31 Prairie Oil & Gas Company of every nature and kind which may be reasonably necessary and essential to the conduct of the business of gathering and transporting oil in interstate commerce by means of pipe lines, and to prosecute, conduct and operate the business in which such property is now employed, and that The Prairie Oil & Gas Company discontinue the transaction and conduct of such business.

Now, Therefore, be it Resolved: That the Board of Directors of The Prairie Oil & Gas Company be, and said Board is hereby instructed, authorized and directed to procure the organization of a corporation under the laws of such one of the states as such Board shall select; to cause all of the property and funds of The Prairie Oil & Gas Company necessary or useful to the business of gathering and transporting oil by means of pipe lines in interstate commerce to be sold, conveyed and transferred to such new corporation, and to accept and receive in payment therefor the capital stock of such corporation, issued to, and for distribution among, the stockholders of The Prairie Oil & Gas Company pro rata according to their respective holdings in said The Prairie Oil & Gas Company, as may be shown by the stock records of said company on such day as shall be determined by the Board of Directors of this company after fourteen days' notice thereof shall have been mailed to each stockholder; provided that the par value of the capital stock of said corporation to be organized as aforesaid shall not exceed the reasonable value of its property and funds.

Resolved: That a sub-committee composed of W. F. Gates and C. H. Kountz be appointed by this Board and authorized to negotiate with a committee appointed by The Prairie Oil & Gas Company to ascertain at what price and under what conditions The Prairie

Oil & Gas Company might be willing to dispose of its pipe lines and other appurtenances necessary in the operation of the same (including private telephone and telegraph system) in the states of Indiana, Illinois, Iowa, Missouri, Kansas, Oklahoma and Arkansas; and that said committee conduct such negotiations as soon as possible and report the result of its negotiations to this Board for final action.

EXHIBIT C.

Whereas, The Prairie Pipe Line Company, a corporation, has been organized under the laws of the State of Kansas, with an authorized capital stock of Twenty-seven million (\$27,000,000) Dollars and authority under its charter to purchase, own and operate a system of pipe lines, such as is now owned and operated by this company for the gathering and transporting of crude oil;

And Whereas, said corporation, The Prairie Pipe Line Company, has made a proposition to purchase the pipe line property of
33 The Prairie Oil & Gas Company, now owned and used by it in the gathering and transportation of crude oil, at fair and reasonable prices and deliver in payment therefor Twenty Seven Million (\$27,000,000) Dollars of the capital stock of said The Prairie Pipe Line Company, with the understanding and upon condition, however, that if the aggregate value of the property so sold and purchased, which cannot be at this date fully determined, shall exceed the sum of Twenty-Seven Million (\$27,000,000) Dollars, The Prairie Pipe Line Company will pay in cash an amount equal to such excess, and in case such amount, when fully determined, shall be less than Twenty-Seven Million (\$27,000,000) Dollars, then and in that event The Prairie Oil & Gas Company shall turn over to said Pipe Line Company an amount in cash which will make the combined value of such property sold and delivered and such cash turned over equal the sum of Twenty Seven Million (\$27,000,000) Dollars.

Now, Therefore, be it Resolved: That it is in the judgment of this Board of Directors and its individual members, to the interests of the stockholders that such sale and transfer be consummated in accordance with the resolution adopted at the stockholders' annual meeting, as aforesaid.

Be it Further Resolved: That a certain written contract for the consummation of the sale and transfer above described, which is this day submitted to this Board, by a special committee heretofore
appointed to confer with The Prairie Pipe Line Company in
34 this matter, in a manner satisfactory to this Board sets forth the basis, terms and conditions upon which The Prairie Oil & Gas Company, acting through its Board of Directors, desires such sale and transfer to be made.

And be it Further Resolved: That the President, J. E. O'Neil, be, and he is hereby, authorized and directed on behalf of The Prairie Oil & Gas Company to execute said contract in duplicate; that J. A. Hollihan, Secretary of The Prairie Oil & Gas Company, is author-

ized and directed to attest the same and attach the corporate seal of this company.

And be it Further Resolved: That all deeds, assignments, conveyances and other necessary papers and documents which may be required to be executed in the consummation of said contract and sale shall be executed on behalf of The Prairie Oil & Gas Company by W. S. Fitzpatrick, its Vice-President, and attested under the seal of this corporation by its Secretary.

EXHIBIT D.

Whereas, Growing out of negotiations heretofore conducted and considered between this Company and The Prairie Oil & Gas Company, relating to the purchase by this Company of the pipe line system owned and operated by The Prairie Oil & Gas Company in the gathering and transportation of crude oil and the property appurtenant thereto and used in connection therewith, said corporation, The Prairie Oil & Gas Company, has made a proposition to sell the pipe line property of The Prairie Oil & Gas Company, now owned and used by it in the gathering and transportation of crude oil, at fair and reasonable prices and receive in payment therefor Twenty Seven Million (\$27,000,000.00) Dollars of the capital stock of said The Prairie Pipe Line Company, with the understanding and upon condition, however, that if the aggregate value of the property so sold and purchased, which cannot at this date be fully determined, shall exceed the sum of Twenty Seven Million (\$27,000,000.00) Dollars, The Prairie Pipe Line Company will pay in cash an amount equal to such excess, and in case such amount, when fully determined, shall be less than Twenty Seven Million (\$27,000,000.00) Dollars, then and in that event The Prairie Oil & Gas Company shall pay to the said The Prairie Pipe Line Company an amount in cash which, when added to the value of such property sold and delivered, will equal the sum of Twenty Seven Million (\$27,000,000.00) Dollars.

Now, Therefore, be it Resolved, That the price at which said property is offered for sale, amounting in the aggregate to approximately Twenty Seven Million (\$27,000,000.00) Dollars, is a fair and reasonable price for the same and does not exceed the cost of present construction of a pipe line of equal length with equal capacity and equipment.

And be it Further Resolved, That a certain written contract for the consummation of the sale and transfer above described, which is this day submitted to this Board, by a special committee heretofore appointed to confer with The Prairie Oil & Gas Company in this matter, in a manner satisfactory to this Board sets forth the basis, terms and conditions upon which The Prairie Pipe Line Company, acting through its Board of Directors, desires such purchase to be made.

And be it Further Resolved, That the President, W. F. Gates, be, and he is hereby authorized and directed on behalf of The Prairie

Pipe Line Company to execute said contract in duplicate; that F. M. Wilhelm, Secretary, is authorized and directed to attest the same and attach the corporate seal of this Company.

And be it Further Resolved, That upon the delivery to the Secretary of this Company by The Prairie Oil & Gas Company of a list of the stockholders of said Company, with the address of each stockholder and the amount of stock in The Prairie Pipe Line Company which it desires to have issued to each, not exceeding in the aggregate 270,000 shares, it is hereby ordered and directed that the Secretary of this Company cause certificates for shares and fractions of shares to be issued in accordance with such list, and that when the stock of this Company is so issued the same shall be mailed by registered mail, with the knowledge, consent and under the supervision of the Secretary of The Prairie Oil & Gas Company, to the several persons to whom the same shall be issued at the address furnished by said The Prairie Oil & Gas Company, as aforesaid;

And be it Further Resolved, That C. H. Kountz, Vice-President, be and he is hereby authorized on behalf of The Prairie Pipe Line Company to make, execute and file all necessary tariffs, supplements and amendments to tariffs, either of The Prairie Oil & Gas Company or The Prairie Pipe Line Company, and all concurrences that may be required by law or the rules and regulations of the Interstate Commerce Commission in connection with the purchase, acquisition and taking over of the pipe lines of The Prairie Oil & Gas Company, and is further authorized and directed to demand from The Prairie Oil & Gas Company and to receive and approve such deeds, conveyances, assignments and title papers as may be necessary to vest in The Prairie Pipe Line Company the full ownership and possession of the property purchased under contract this day executed between The Prairie Oil & Gas Company and The Prairie Pipe Line Company.

EXHIBIT E.

This agreement, Made and entered into by and between The Prairie Oil and Gas Company, a corporation, party of the first part, and The Prairie Pipe Line Company, a corporation, party of the second part,

Witnesseth, That for and in consideration of the covenants, promises and agreements of the party of the second part, hereinafter set out, the party of the first part hereby undertakes and agrees that it will sell, convey, transfer, set over, and deliver to party of the second part all the pipe lines now owned and used by it in the gathering and transportation of oil in interstate commerce, together with all pumping stations, oil tanks, machinery and equipment of every nature and kind (including private telegraph and telephone lines), necessary or useful in the operation of said gathering lines and pipe

lines, and all lands and rights-of-way upon which any or all of the property above mentioned and referred to shall be situated;

Second. Party of the first part will deliver to party of the second part all of the property above mentioned and referred to so that second party may begin on the 1st day of February, 1915, and thereafter continue, the transportation of oil throughout the system of such pipe lines, and that thereafter, as speedily as the same can be accomplished, first party will cause to be executed and delivered to second party the necessary deeds, conveyances, assignments, and other title papers, to the end that all the titles, rights, and privileges in, to, or connected with the ownership of first party to any and all of the property hereinbefore mentioned and referred to shall be fully vested in The Prairie Pipe Line Company;

39 Third. Party of the second part hereby agrees to purchase all the property, rights, and privileges hereinbefore mentioned and referred to, and pay to The Prairie Oil and Gas Company therefor the actual cost of the same as shown by investment records of The Prairie Oil and Gas Company on the 31st day of January, 1915.

Fourth. Party of the second part agrees that in consideration of the sale, conveyance, transfer and delivery of the aforesaid property, which shall include the working stocks of oil in said pipe lines and tanks on the 1st day of February, 1915, it will issue and deliver to the party of the first part Two hundred Seventy Thousand (270,000) shares of its capital stock of the par value of One Hundred (\$100.00) Dollars per share, in such number of shares or fractions of shares as may be necessary for the actual distribution of such stock among the stockholders of The Prairie Oil and Gas Company, in accordance with a list to be furnished by said first party, showing the names and number of shares or the fraction of a share belonging to each, such list to be filed with the Secretary of the second party on or before the -- day of March, 1915.

Fifth. It is mutually agreed between the parties hereto that if the aggregate cost of the property delivered to and received by party of the second part, determined in the manner aforesaid, shall not equal the sum of Twenty Seven Million (\$27,000,000.00) Dollars, the par value of the capital stock to be issued in exchange therefor, then and in that case party of the first part shall pay to party of the
40 second part in cash such sum as may be necessary, when added to the value of such property to equal Twenty Seven Million Dollars (\$27,000,000.00), and if the cost of such property so delivered and received, shall be in excess of Twenty Seven Million (\$27,000,000.00) Dollars, then and in that case, party of the second part agrees to pay to party of the first part such excess in cash.

In Witness Whereof, This instrument is executed in duplicate by the President and Attested by the Secretary, under seal of each of the above named contracting parties, each having been first there

into duly authorized by the Board of Directors of the respective companies which they represent, this the 21st day of January, 1915.

THE PRAIRIE OIL AND
GAS COMPANY.

By J. E. O'NEIL,
President.

Attest:

J. A. HOLLIHAN,
Secretary.

THE PRAIRIE PIPE LINE
COMPANY.

By W. F. GATES,
President.

Attest:

F. M. WILHELM,
Secretary.

EXHIBIT F.

Whereas, The Prairie Oil & Gas Company, through its authorized officers, has this day entered into an agreement with the proper officials of The Prairie Pipe Line Company to sell to The Prairie Pipe Line Company its pipe lines with all appurtenances thereunto belonging, and to receive in payment therefor the capital stock of The Prairie Pipe Line Company, amounting to one hundred and seventy thousand (270,000) shares of the par value (One Hundred (\$100.00) Dollars each, or Twenty Seven Million (\$27,000,000) Dollars, and

Whereas, It is not the intention of this company to retain the aforesaid capital stock of The Prairie Pipe Line Company, but that it is the purpose of this company that such capital stock of The Prairie Pipe Line Company be distributed pro rata amongst the stockholders of The Prairie Oil & Gas Company in accordance with their holdings in said company on February 9th, 1915, as may be shown by the stock records of this company.

Now, Therefore, be it Resolved: That the stock transfer books of this company be and the same are hereby closed for the transfer of shares from and after February 9th, 1915, up to and including February 23rd, 1915.

Be it Further Resolved: That the Secretary of this company furnish to The Prairie Pipe Line Company a list of the stockholders of this company as shown by the stock books on February 9th, 1915, together with the number of shares held by each, and when The Prairie Pipe Line Company shall have issued to each of such stockholders its stock in amount equal to one and one-half times the amount of stock held by him or her in The Prairie Oil & Gas Company, then the said Secretary is hereby directed to make, or cause to be made, the proper distribution of such stock in The Prairie Pipe Line Company among the stockholders of The Prairie Oil & Gas Company, as above provided.

EXHIBIT G.

Directors' Meeting.

November 30th, 1914.

Meeting of the Directors of the Ohio Oil Company, Duly Called and Held at the General Office of said Company, in the City of Findlay, Ohio, on the 30th Day of November, A. D. 1914, at Ten o'clock, A. M., with J. C. Donnell, President, in the Chair.

Present: J. C. Donnell, R. J. Berry, O. D. Donnell and F. E. Hurley.

The Secretary read the minutes of the previous meeting, and on motion duly seconded same were approved as read.

The President stated that the Illinois Pipe Line Company had been incorporated under the Laws of the State of Ohio for the purpose of transporting petroleum and water, and purchasing, leasing, acquiring, constructing, and holding and disposing of Pipe Lines and Pipe Line property, and it is the purpose of the Incorporators to make a proposition to The Ohio Oil Company to purchase its Pipe Line property in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems; and that the Books for Subscription to the Capital Stock of said The Illinois Pipe Line Company have been opened. Mr. F. E. Hurley then offered the following Resolution:

Resolved: That the President of this Company be, and he is hereby authorized to subscribe on behalf of The Ohio Oil Company to 199-995 shares of the Capital Stock of The Illinois Pipe Line Company, and to pay for the same at such time and in such installments as may be required by law, or by the Directors of said Corporation.

On motion of R. J. Berry, seconded by O. D. Donnell, the above Resolution was unanimously adopted.

There being no further business, the meeting on motion adjourned.
(Signed) F. E. HURLEY,

Secretary.

EXHIBIT H.

Whereas: It being made known to the stockholders of this company that the pipe line property of The Ohio Oil Company, located in the states of Ohio, Indiana, Illinois and Pennsylvania, would be offered for sale, and it appearing desirable for the purposes of this company to acquire such property;

Be it therefore resolved: That the directors of this Company be authorized to make a proposition for the purchase of the pipe line property of The Ohio Oil Company located in the states of Ohio, Indiana, Illinois and Pennsylvania, including its trunk and gathering line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand dollars, and

offer therefor the sum of twenty million dollars, and in case of the acceptance of said proposition by The Ohio Oil Company, that the directors be, and they are hereby authorized and directed to do all the things necessary or proper to carry into effect and complete the purchase of said property.

EXHIBIT I.

Whereas: The stockholders of this company have authorized the directors to make a proposition to The Ohio Oil Company for the purchase of the pipe line property of The Ohio Oil Company in Ohio, Indiana, Illinois and Pennsylvania, including its trunk and gathering pipe line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand dollars, and to offer therefor the sum of twenty million dollars.

Now, Therefore, be it Resolved: That the President of this company be, and he is hereby authorized and directed in accordance with the authorization and instruction of the stockholders of this company, to make the following proposition to the said The Ohio Oil Company for the purchase of said pipe line property:

The Illinois Pipe Line Company, a corporation organized under the laws of the state of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand dollars, in accordance with the schedule attached hereto which has been furnished to The Illinois Pipe Line Company by The Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition.

The Illinois Pipe Line Company agrees to pay for said property and cash the sum of twenty million dollars, which payment shall be made in cash, or in cash and notes, or in the paid up capital stock of this company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition, the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable.

EXHIBIT J.

Findlay, Ohio, November 30, 1914.

To the Ohio Oil Company:

The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the States of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto, and cash in the sum of two hundred thousand (\$2000,000.00) Dollars, in accordance with the

schedule attached hereto which has been furnished to the Illinois Pipe Line Company by The Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition.

The Illinois Pipe Line Company agrees to pay for said property the sum of \$20,000,000, which payment shall be made in cash, or in cash and notes, or in the paid up capital stock of this Company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable.

THE ILLINOIS PIPE LINE
COMPANY,

By J. R. PENN, JR.,
President.

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EXHIBIT K.

Whereas The Illinois Pipe Line Company has made the following proposition to The Ohio Oil Company for the purchase of its pipe line property:

The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto and cash in the sum of Two Hundred Thousand Dollars, in accordance with the schedule attached hereto which has been furnished to The Illinois Pipe Line Company by the Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition. "The Illinois Pipe Line Company agrees to pay for said property the sum of \$20,000,000.00, which payment shall be made in cash, or in cash and notes, or in the paid up Capital Stock of this Company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition, the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable."

And Whereas: On account of the importance of the question involved in said proposition, it is the sense of this board that
48 the same should be submitted to the stockholders of the Company for determination; therefore,

Be it Resolved: That a special meeting of the stockholders of The Ohio Oil Company be called and held at its principal office in the City of Findlay, Ohio, on the 21st day of December A. D., 1914, at ten o'clock, A. M., of that day, for the purpose of considering and acting upon the proposition made by The Illinois Pipe Line Company, and that the Secretary be, and he is hereby instructed and directed to mail to all stockholders proper notice of said meeting, setting forth the time and place of the same, and the purpose for which it is to be held.

EXHIBIT L.

Whereas, The Board of Directors of The Ohio Oil Company has received the following proposition from The Illinois Pipe Line Company to purchase its pipe line property:

"The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, makes the proposition to The Ohio Oil Company to purchase from The Ohio Oil Company its pipe line property located in the states of Ohio, Indiana, Illinois and Pennsylvania, including both the trunk and gathering pipe line systems with the equipment belonging thereto and cash in the sum of Two hundred thousand dollars, in accordance with the schedule attached hereto which has been furnished to The Illinois Pipe Line Company by The Ohio Oil Company in a preliminary negotiation for this property, and which schedule is made a part of this proposition.

The Illinois Pipe Line Company agrees to pay for said property the sum of \$20,000,000, which payment shall be made in cash, or in cash and notes, or in the paid up Capital Stock of this Company, as may be determined by the parties hereto, in case this proposition is accepted. In case of the acceptance of the proposition, the transfer of said pipe line property is to take effect as of January 1st, 1915, or as soon after that time as practicable."

Now, therefore, be it resolved, that the said proposition be and the same is hereby accepted and that the Board of Directors of this Company be and hereby are fully authorized, instructed and empowered to accept the said proposition for the sale of all the Company's pipe line property, including both the trunk and gathering pipe line systems with the equipment belonging thereto and located in the states of Ohio, Indiana, Illinois and Pennsylvania, and

Further resolved, that the Board of Directors of this Company be and hereby are authorized, instructed and empowered to sell and dispose of said pipe line property, including both the trunk and gathering pipe line systems with the equipment belonging thereto aforesaid, together with cash in the sum of Two hundred thousand dollars, at such time and upon such terms and conditions

as is provided in said proposition and as to them may seem best, hereby giving said Board of Directors full power and authority to act in behalf of The Ohio Oil Company in the sale of its said pipe line property, and to do all things necessary for the proper consummation of the sale and transfer of the said pipe line property.

EXHIBIT M.

Whereas, The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, has made a proposition to purchase all of The Ohio Oil Company's pipe line property, including both the trunk and gathering pipe line systems with the equipment

belonging thereto and located in the states of Ohio, Indiana, Illinois and Pennsylvania, and to pay therefor the sum of \$20,000,000, which payment shall be made in cash, or in cash and notes, or in the paid up Capital Stock of The Illinois Pipe Line Company; and

Whereas, the stockholders of The Ohio Oil Company have duly and regularly approved of said proposition and authorized and directed that the said Board of Directors sell said pipe line property at such time and upon such terms and conditions as are provided in said proposition and as to them may seem best;

Now, therefore, be it resolved, That the said proposition be
51 and the same is hereby accepted by this Company, and that the Board of Directors of The Ohio Oil Company hereby agrees to sell and convey to The Illinois Pipe Line Company, a corporation organized under the laws of the State of Ohio, all of its said pipe line property, including both the trunk and gathering pipe line systems, with the equipment belonging thereto and located in the states of Ohio, Indiana, Illinois and Pennsylvania, and cash in the sum of Two Hundred Thousand Dollars, upon the following terms, to wit: Payment by The Illinois Pipe Line Company of 200,000 shares of its Capital Stock of the par value of \$20,000,000.00; transfer of said property to take effect as of January 1st, 1915.

Further resolved, That the President, or one of the Vice-Presidents, and the Secretary of the Company are hereby empowered and instructed to execute all proper instruments to carry such acceptance into effect and on behalf of this Company to receive the said 200,000 shares of the Capital Stock of The Illinois Pipe Line Company, and to do all such other things in connection with such sale and the said transfer of the property as may be found necessary for its proper consummation.

Whereas, by reason of the sale of its pipe line property, The Ohio Oil Company will receive on January 1st, 1915, the entire Capital Stock of The Illinois Pipe Line Company, consisting of 200,000 shares of the par value of \$100.00 per share; and

52 Whereas, it is the sense of this board that a distribution of said stock should be made to the stockholders of this Company;

Now, therefore, be it resolved, That a pro rata distribution of said stock be made to stockholders of The Ohio Oil Company of record January 2nd, 1915, and that certificates representing said stock be mailed to stockholders on February 1st, 1915, or as soon thereafter as possible; and further, that the transfer books of this Company be closed from 12 o'clock m. on January 2nd, 1915, until 8 o'clock a. m., February 1st, 1915.

EXHIBIT N.

Findlay, Ohio, January 1st, 1915.

Received of The Illinois Pipe Line Company Certificate No. 1, for Two Hundred Thousand (200,000) Shares of the Capital Stock of said The Illinois Pipe Line Company, of the par value of One Hun-

dred Dollars (\$100.00) each, said Stock being in payment for the Pipe Line property of The Ohio Oil Company located in the States of Ohio, Indiana, Illinois and Pennsylvania, including both the Trunk and Gathering Pipe Line Systems, with the equipment belonging thereto, and cash in the sum of Two Hundred Thousand (\$200,000.00) Dollars, pursuant to a proposition made to The Ohio Oil Company, under date of November 30th, 1914, and in accordance with the schedule attached to and made a part of said proposition, and which said proposition was accepted by The Ohio Oil Company.

By agreement between The Ohio Oil Company and The Illinois Pipe Line Company the transfer of said property takes effect as of January 1st, 1915. All of the instruments necessary to pass title to rights of way, real estate, etc., to The Illinois Pipe Line Company, have not yet been made, but these instruments will be made and executed with all possible dispatch.

THE OHIO OIL COMPANY,
By J. C. DONNELL,
President.

United States District Court, Southern District of New York.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Harkness,
Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of the State of New York, Defendant.

Defendant above named by William Hayward, United States Attorney for the Southern District of New York, his attorney, demurs to the amended complaint herein upon the ground that the same does not state facts sufficient to constitute a cause of action.

Wherefore, defendant demands judgment dismissing said amended complaint together with the costs and disbursements of this action.

WILLIAM HAYWARD,
*United States Attorney for the Southern District of
New York, Attorney for Defendant.*

Office and Post Office Address: U. S. Courts and P. O. Building,
Borough of Manhattan, City of New York.

[Endorsed:] Form No. 336. U. S. District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, executors of the last will and testament of William L. Harkness, deceased, plaintiffs, versus William H. Edwards, Collector of U. S. Internal Revenue for the Second District of the State of New York, defendant. Demurrer. William Hayward, United States Attorney, Attorney for Defendant.

56 United States District Court, Southern District of New York.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Hark-
ness, Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of the State of New York, Defendant.

Please to take notice that the issues of law raised by the demurrer of the defendant to the amended complaint in the above entitled action, will be brought on for argument at a stated term of this Court for the hearing of motions to be held at the United States Courts and Post Office Building, in the Borough of Manhattan, City, County, State and Southern District of New York, on the 30th day of June, 1921, at 10 o'clock in the forenoon of said day, or as soon thereafter as counsel can be heard.

Dated: June 28, 1921.

Yours, etc.,

WILLIAM HAYWARD,

*United States Attorney for the Southern District of
New York, Attorney for Defendant.*

Office & Post Office Address: U. S. Courts & P. O. Building,
Borough of Manhattan, City of New York.

To Murray, Prentice & Aldrich, Esqs.,
Attorneys for Plaintiffs.

57 [Endorsed:] Form No. 336. U. S. District Court, South-
ern District of New York. The New York Trust Company
and Edith Hale Harkness, executors of the last will and testament of
William L. Harkness, deceased, plaintiffs, versus William H. Ed-
wards, Collector of U. S. Internal Revenue for the Second District
of the State of New York, defendant. Notice. William Hayward,
United States Attorney, attorney for defendant.

58 United States District Court, Southern District of New York.

NEW YORK TRUST COMPANY and Others, as Executors of William
L. Harkness,

against

WILLIAM H. EDWARDS, Collector.

UNITED STATES OF AMERICA

against

JOHN D. ROCKEFELLER.

These cases involve the legality of the income tax levied upon the plaintiff in the Harkness case and the defendant in the Rockefeller case. The question turns on the effect of certain corporate actions taken by the Prairie Oil & Gas Company and the Ohio Oil Company during the winter of 1914-15.

The Prairie Oil & Gas Company was the owner of pipe line property and oil property and for reasons not here relevant felt itself forced to separate these two into two separate corporations. In pursuance of that purpose it caused a corporation to be organized known as the The Prairie Pipe Line Company. It then made a contract with the pipe line company by which it was to convey all its pipe line property to it, in consideration of which the pipe line company promised to distribute all its own stock to the stockholders of the oil company in the same proportion as their existing holdings. This was carried out and the shares of the pipe line company so received by Harkness and Rockefeller were taxed as part of their income for the year in which the shares were issued.

59 The transaction in the case of the Ohio Oil Company was similar except that the agreement between it and the Illinois Pipe Line Company, which it organized, required the shares to be transferred direct to the oil company. However, the resolution of the directors of the oil company which accepted the contract, declared as a dividend all the shares to be received from the pipe line company and directed them to be distributed among its stockholders in accordance with their existing holdings. This agreement was carried out as well, and the shares so declared were also taxed as income against Harkness and Rockefeller as in the case of the Prairie Oil & Gas Company. In both cases the pipe line properties represented a surplus above the par value of the oil companies' stock; the conveyances therefore left the oil companies' capital unimpaired and required no reduction in their authorized issues.

Richard S. Holmes, Charles A. Mapes and Newton K. Fox for the United States.

George Wellwood Murray and Harrison Tweed for Harkness and Rockefeller.

LEARNED HAND, *D. J.*:

Neither the Prairie Gas & Oil Company nor the Ohio Oil Company for any moment of time owned the pipe line shares as free assets. This is very clear in the case of the Prairie Company, the transaction in which,—observing now the most scrupulous formality,—was this. The pipe line company offered to buy the oil company's pipe line assets for \$27,000,000,—adjusted to actual values,—and to give in payment its own shares to be directly distributed by the pipe line company pro rata among the oil company's stockholders. This offer the oil company accepted and the contract of January 21, 1915,

60 bound the buyer so to distribute the stock, which it did. This was a contract made for the sole benefit of the oil company's stockholders and could probably have been directly enforced by them at law, *Hendrick v. Lindsay*, 93 U. S. 143, *National Bank v. Grand Lodge*, 98 U. S. 123, 124, (semble). Yet it was the only contract by which the oil company ever got any conceivable interest in the pipe line shares, and it gave that company no such interest. It had given away its property for a consideration moving directly to third persons.

In the case of the Ohio company, formally the contract bound the pipe line company to deliver its shares to the oil company and they thus would have become free assets, if there had been nothing more. However, in the very resolution of the oil company's board of directors by which the offer of the pipe line company was accepted the board declared a pro rata distribution of the pipe line shares among its own stockholders. Thus at the moment of concluding the contract by which alone the oil company got any interest in the shares, the property so acquired was declared as a dividend. That declaration gave the stockholders of the oil company an immediate vested right to the dividend so declared, *Staats v. Biograph Co.*, 235 Fed. R. 454, (C. C. A. 2nd), *Hopper v. Sage*, 112 N. Y. 530, *Raynolds v. Diamond Mills Paper Co.*, 69 N. J. Eq. 299, 300.

Therefore I think that *Peabody v. Eisner*, 247 U. S. 347, does not apply. I agree that had these shares been once free treasury assets it would be impossible to distinguish that case; the dividend would have been declared in specific property. But since the shares even in the case of the Ohio company were always the property of the stockholders the transactions must be taken as a whole, and the case determined from their effect upon the rights of the stockholders.

61 A dividend may be income to the stockholder though declared out of property which has long since become a part of the economic capital of the corporation, *Peabody v. Eisner*, *supra*, *Lynch v. Hornby*, 247 U. S. 339. True, it must not be a dividend in liquidation, *Lynch v. Turrish*, 247 U. S. 221, and perhaps it must on that account be from a corporate surplus, since otherwise it is hard to avoid regarding it as in liquidation. But it makes no difference that it distributes to the stockholder property which is not current profit, but the means of producing current profit. He must still pay an income tax upon it, though in his eyes it is a part of his capital. Therefore, in the cases at bar, the only question is of the

completeness of severance of the property declared, i. e., the control of it acquired by the stockholder and lost by the corporation.

In *Eisner v. Macomber*, 252 U. S. 189, the case was of a mere stock dividend, which was held to be no more than new evidence of the stockholder's original ownership. Had the shares been without par value, that would have been literally the case, but they were not. The stock dividend did change the relation of the corporation and the stockholder to the surplus, by permanently impounding it, as it were, in the business, and giving the stockholder a right to insist upon it as an investment, should his fellows later wish to realize it as profit. Yet though he thus got, and the corporation lost, this element of control over the surplus so declared, it was not regarded as a severance of the property. So far, therefore, *Eisner v. Macomber*, supra, helps the taxpayers here; it shows that there may be some changes in the relation of the stockholders to the surplus which do not amount to the severance of income.

62 Nevertheless, the cases at bar go further than that case because in them the surplus was transferred to a new corporation altogether, and the question is whether that distinction changes the result. The taxpayers insist that if one looks at the very truth of the matter, disregarding corporate forms, this is no difference at all. Although the argument is plausible, it still seems to me, that, even when viewed with the completest disregard of forms, the pipe line properties were completely severed from the oil companies and that the resulting shares were new property derived from the old shares.

A corporation, stripped of its fictitious personality, is an association of persons mutually agreed upon the execution of more or less definitely expressed purposes, publicly registered as the law requires. In the case of industrial corporations the personnel of the membership is an immaterial matter; the original members leave as they please and their substitutes enter merely by purchase. Even the number of the members changes from time to time. If so, it is the common purposes and their execution alone that determine the corporation and whatever substantially changes these changes the corporation itself, and the rights of its stockholders.

The result of the conveyance of the pipe line property was to put it under the control of an association committed exclusively to its operation as a separate enterprise from that of the oil company. Indeed, this severance in management was the sole motive of the transaction, unless there were a surreptitious agreement between the two groups which nullified the dissolution, which is not suggested. Accepting therefore, the taxpayers' argument that — should be disre-

63 manage the pipe line property independently of the oil property, is a different group from one agreeing to manage the pipe line and the oil property jointly. If the association does not depend upon the number or makeup of its membership but upon its charter, there can be no question that the difference between the two is substantial, because to conduct two businesses as a unity has practical results very different from conducting them in complete independence.

For illustration let me assume that the pipe line property had been conveyed in specie to the stockholders as co-owners and that they had incorporated for convenience. The original conveyance to them would have fallen directly within *Peabody v. Eisner*, supra, and *Lynch v. Hornby*, supra. It would have made no difference that they had later incorporated. Yet judged by results, this is exactly what happened; the pipe line was broken from an association committed to its joint management with the oil properties and consigned to an association which must manage it alone.

Or suppose that the *Prairie Pipe Line Company*, for example, had been a going concern with property of its own. Upon its acquisition of the pipe line and the issue of its new shares to the oil company stockholders, they would have an interest in an association operating two properties? These new shares would certainly be income in their hands to some extent. Would they be altogether income or only in the proportion to which by taking the new shares they gave up their rights in the old pipe line and got in exchange an interest in the original property of the *Prairie Pipe Line Company*? I scarcely think that anyone would urge that the new shares were not altogether income. Yet, if so, they would become such only because

the pipe line was being conducted in a new joint enterprise by the *Prairie Pipe Line Company*. Unquestionably the oil company stockholders would to some extent be still holding their old pipe lines and in the same relative proportions.

Or consider again the analogy of many of the dissolutions under the Sherman Act. These consisted in no greater separation than was accomplished here, yet it was thought enough to sever the enterprises and create new rights in the new corporations. Nor was it thought to be an answer that the stockholders started out the same. Because the members might join or leave the new group which conducted only a part of the old business, it was considered that the old group was effectively broken up.

Disregarding, therefore, all formalities, it appears to me, that the pipe-line properties were as effectually severed from the old corporations as though they had been distributed in kind. Indeed, the form adopted was the only practicable way in which they could be so distributed. It is only when one fastens one's attention upon the momentary identity of the two resulting groups that there can be any question of the result. But, as I have perhaps too often said, that identity is nothing unless its continuance is insured for the future by some common agreement between the two. I think that the new shares were income under the law and that the tax was legal.

Southern Pac. Co. v. Lowe, 247 U. S. 330, is not to the contrary; there the assets taken over had always been in the actual possession and under the control of the corporation. All the shares of the subsidiary were owned by it and the two were treated as merged. Nothing of the sort is true in the cases at bar. In *Gulf Oil Company v. Lewellyn*, 248 U. S. 71, it is indeed true that the property of the subsidiaries was not in the possession of the parent corporation, but it owned all their shares, and they

were all "a single enterprise", controlled by it. In no sense did the pipe line companies and the oil companies here remain "a single enterprise". They might in fact be so conducted for a period, but if so, it would only be by the spontaneous assent of two independent groups of persons. If they remained in fact "a single enterprise", the whole plan was a mere cover.

Phellis v. U. S. Court of Claims, March, 1921, was a case where all the assets were sold to another corporation, which,—omitting irrelevant details,—gave its own shares, two for one, to the old stockholders and conveyed its debenture shares to the old company par for par. The result was that the old stockholders had their old shares now represented by the assets of the old corporation, i. e., the debenture shares in the new corporation, and double their original holdings in common shares of the new corporation. Whatever may be the proper answer to the case, with the greatest deference I cannot follow the reasoning of the learned judge, now urged upon me as authoritative. That reasoning is that because the joint value of the old and new shares after the transfer was the same as that of the old shares before, there can have been no income to the stockholder. It may of course happen that in the case of the distribution of the dividends, the value of the old shares does not fall as much as the value of the dividend, though generally the correspondence is pretty close. It does not make any difference for taxing purposes whether it does or not. The surplus declared as dividend may or may not be represented in the value of the shares, but even though it be fully represented, the dividend becomes income, as soon as the stockholder gets it. On his books it may appear as a capital distribution, depending on whether he carries his investment at par. That is not to the point. It was not his property before, it has become such by the declaration of the dividend.

Demurrers sustained; judgment absolute on the demurrers, dismissing Harkness's complaint and awarding recovery against Rockefeller as prayed.

L. H.,
D. J.

August 3, 1921.

- 67 At a Stated Term of the United States District Court for the Southern District of New York Held in the United States Court and Post Office Building, Borough of Manhattan, City, County, and State of New York, on the 8th Day of September, 1921.

Present: Honorable Learned Hand, District Judge.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNES,
Executors of the Last Will and Testament of William L. Hark-
ness, Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of New York, Defendant.

The issues of law raised by the demurrer of the defendant to the amended complaint herein having duly come on to be heard by this Court.

Now, after hearing Richard S. Holmes, Special Assistant United States Attorney for the Southern District of New York, of counsel for the defendant in support of said demurrer, and George Welwood Murray, Esq., of counsel for the plaintiffs in opposition thereto, and due deliberation having been had thereon, on motion of William Hayward, United States Attorney for the Southern District of New York, attorney for the defendant, it is

- Ordered that the demurrer of the defendant to the amended complaint herein be and the same hereby is in all respects sustained and it is

68 Further ordered that the amended complaint herein be and the same hereby is dismissed upon the merits and that defendant have final judgment against the plaintiffs dismissing said amended complaint upon the merits and for his costs to be taxed.

LEARNED HAND.

U. S. D. J.

- 69 United States District Court, Southern District of New York.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNES,
Executors of the Last Will and Testament of William L. Harkness,
Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of New York, Defendant.

The issues of law raised by the demurrer of the defendant to the amended complaint of the plaintiffs herein having duly come on to be heard before the Honorable Learned Hand, United States District Judge, at a stated term of this Court held on the 1st day of July, 1921, and Richard S. Holmes, Esq., Special Assistant United States At-

attorney for the Southern District of New York, of counsel for the defendant, having been heard in support of said demurrer, and George Welwood Murray, Esq., of counsel for the plaintiffs, having been heard in opposition thereto, and due deliberation having been had thereon, and the Court having handed down its opinion on the 3rd day of August, 1921, sustaining said demurrer and an order having been duly made and entered on the 8th day of September, 1921, sustaining said demurrer to the amended complaint of the plaintiffs herein and ordering that said amended complaint be dismissed upon the merits and that the defendant have final judgment against the plaintiffs dismissing said amended complaint upon the merits and for his costs to be taxed and the costs of said defendant having been taxed in the sum of \$36.95,

Now, on motion of William Hayward, United States Attorney for the Southern District of New York, attorney for defendant, it is

Adjudged that the amended complaint herein be and it hereby is dismissed upon the merits and that the defendant have and recover of the plaintiffs the sum of \$36.95 his costs as taxed and that said defendant have execution therefor.

Judgment signed this 9th day of September, 1921.

[SEAL.]

ALEX. GILCHRIST, JR.,

Clerk.

United States District Court, Southern District of New York.

L 25-19.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Harkness,
Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of New York, Defendant.

Petition for Writ of Error.

To the United States Supreme Court:

The above named The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, now appear before this Court and complain that in the records and proceedings had in this cause, and also in the rendition of the judgment in the above entitled cause in the United States District Court, for the Southern District of New York, on the 9th day of September, 1921, manifest error hath happened to the great damage of said plaintiffs, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore the said plaintiffs hereby pray for the allowance of a writ of error, for an order fixing the amount of the bond for a supersedeas in the said cause, and for such other order and process as may

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cause the aforementioned errors and judgment to be corrected by said United States Supreme Court.

Dated New York, September 10th, 1921.

GEORGE WELWOOD MURRAY,
Attorney for Plaintiffs.

37 Wall Street,
New York, N. Y.

72 [Endorsed:] United States District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, Plaintiffs, against William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, Defendant. Petition for writ of error. Murray, Prentice & Aldrich, Attorneys for Plaintiff-, 37 Wall Street, New York.

73 United States District Court, Southern District of New York.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Harkness,
Deceased, Plaintiffs,
against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of New York, Defendant.

Assignment of Errors.

Now come The New York Trust Company and Edith Hale Harkness, executors of the last will and testament of William L. Harkness, deceased, the plaintiffs herein, and assign error in the decision of the United States District Court for the Southern District of New York, as follows:

First. The Court erred in sustaining the demurrer interposed by the defendant to the amended complaint herein and directing that final judgment should be entered in favor of the defendant.

Second. The Court erred in holding that Section 2 of the Act of Congress of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes,"

74 which was asserted to confer power to make the levies and to compel the payment of the taxes referred to in the amended complaint herein is not in violation of the provisions of Article I, Section 2, Clause 3, of the Constitution of the United States to the effect that "direct taxes shall be apportioned among the several States."

Third. The Court erred in holding that Section 2 of said Act of Congress of October 3, 1913, which was asserted to confer power to make the levies and to compel the payment of the taxes referred to in the amended complaint herein, is not in violation of the provision

of Article I, Section 9, Clause 4, of the Constitution of the United States, to the effect that "no Capitation, or other direct Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken."

Fourth. The Court erred in holding that the shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by the plaintiffs' testator as stated in the amended complaint herein constituted income and were subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States, which provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Fifth. The Court erred in holding that said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein were subject to taxation under Section 2 of said Act of Congress of October 3, 1913.

75 Sixth: The Court erred in holding that the difference between the market value of said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein and the amount by which the surpluses of The Prairie Oil & Gas Company and The Ohio Oil Company were reduced by reason of the transfer of the pipe line properties to The Prairie Pipe Line Company and The Illinois Pipe Line Company constituted income and was subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States.

Seventh. The Court erred in holding that the difference between the market value of said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein and the amount by which the surpluses of The Prairie Oil & Gas Company and The Ohio Oil Company were reduced by reason of the transfer of the pipe line properties to The Prairie Pipe Line Company and The Illinois Pipe Line Company was subject to taxation under Section 2 of said Act of Congress of October 3, 1913.

Eighth. The Court erred in holding that that proportion of the market value of said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein which the value of the pipe line properties acquired out of the proceeds of the sale of stock and bonds and out of earnings accumulated prior to March 1, 1913, bears to the total market value thereof, constituted income and was subject to taxation within the meaning of the Sixteenth Amendment to the Constitution of the United States.

76 Ninth. The Court erred in holding that that proportion of the market value of said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein which the value of the pipe line properties acquired out of the proceeds of

the sale of stock and bonds and out of earnings accumulated prior to March 1, 1913, bears to the total market value thereof, was subject to taxation under Section 2 of said Act of Congress of October 3, 1913.

Tenth. The Court erred in holding that the difference to the stockholders of a corporation is substantial when property formerly held by that corporation is transferred to a newly organized corporation of which that property constitutes the sole assets and all and only the stock of which is received by ~~such~~ stockholders.

Eleventh. The Court erred in holding that there is a substantial difference between the transfer of the surplus of a corporation to capital account and the issue of a stock dividend on the one hand, and, on the other hand, the transfer by a corporation of a part of its property to a newly organized corporation of which that property constitutes the only assets and the distribution to the stockholders of the original corporation of all and only the shares of stock of the newly organized corporation.

Twelfth. The Court erred in holding that the distribution of said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein did not constitute a true stock dividend within the decisions of the Supreme Court of the United States in *Towne v. Eisner*, 245 U. S. 418, and *Eisner v. Macomber*, 252 U. S. 189.

Thirteenth. The Court erred in holding that the distribution of said shares of stock received by the plaintiffs' testator as stated in the amended complaint herein did not constitute a dividend in liquidation within the decision of the Supreme Court of the United States in *Lynch v. Tarrish*, 247 U. S. 221.

Fourteenth. The Court erred in holding that the control of the pipe line properties was acquired by the stockholders of The Prairie Oil & Gas Company and The Ohio Oil Company within the meaning of the decision of the United States Supreme Court in *Eisner v. Macomber*, 252 U. S. 189.

Fifteenth. The Court erred in holding that the pipe line properties were transferred to the separate use and benefit or the individual ownership of the stockholders within the meaning of the decision of the United States Supreme Court in *Eisner v. Macomber*, 252 U. S. 189.

Dated: September 9, 1921.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Plaintiffs.

37 Wall Street,
New York, N. Y.

[Endorsed:] L. 25-19. United States District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, Executors of the last will and testament

of William L. Harkness, deceased, plaintiffs, against William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, Defendant. Assignment of Errors. Murry, Prentice & Aldrich, Attorneys for Plaintiffs, 37 Wall Street, New York.

79 At a Stated Term of the District Court of the United States Held in and for the Southern District of New York, at the Courthouse, in the U. S. Post Office, at the Courthouse Building, in the Borough of Manhattan, City of New York, on the 10th Day of September, 1921.

Present: Hon. Julius M. Mayer, U. S. District Judge.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS, Executors of the Last Will and Testament of William L. Harkness, Deceased, Plaintiffs,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue for the Second District of New York, Defendant.

The above named plaintiffs, The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, having filed a petition for a writ of error and an assignment of errors in the above entitled action, and upon filing a bond in the sum of Two hundred and fifty Dollars (\$250), to be approved by the Court, it is now

Ordered that writ of error be and the same hereby is allowed to have reviewed in the United States Supreme Court the record and proceedings and the judgment heretofore and on the 10th day of September, 1921, rendered in this Court in this cause and it is

Further ordered that the said bond shall operate as a supersedeas bond.

J. M. MAYER,
United States District Judge.

50 [Endorsed:] United States District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, Plaintiffs, against William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, Defendant. Order Allowing Writ of Error. Murray, Prentice & Aldrich, attorneys for plaintiff, 37 Wall Street, New York.

81 District Court of the United States of America for the Southern District of New York, in the Second Circuit.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS,
Executors of the Last Will and Testament of William L. Harkness, Deceased, Plaintiffs-Appellants,

against

WILLIAM H. EDWARDS, Collector of United States Internal Revenue for the Second District of New York, Defendant-Respondent.

Bond on Appeal.

Know all men by these presents, That The New York Trust Company and Edith Hale Harkness, executors of the Last Will and Testament of William L. Harkness, Deceased, as principal, and National Surety Company, a corporation under the laws of the State of New York, with its principal place of business at No. 115 Broadway, in the City, County and State of New York, as surety, are held and firmly bound unto the above named William H. Edwards, collector of United States Internal Revenue for the Second District of New York, in the sum of Two Hundred and Fifty (\$250.00) Dollars to be paid to the said William H. Edwards, collector of United States Internal Revenue for the Second District of New York, for the payment of which well and truly to be made, said principal and surety bind themselves, their heirs, executors, administrators and assigns, jointly and severally, firmly by these presents. Sealed and dated the 9th day of September, 1921.

Whereas, the above named The New York Trust Company and Edith Hale Harkness, executors of the Last Will and Testament of William L. Harkness, deceased, have prosecuted a writ of error to the Supreme Court of the United States to reverse the judgment rendered in the above entitled suit, by a Judge of the District Court of the United States for the Southern District of New York.

Now, therefore, the condition of this obligation is such, that if the above named The New York Trust Company and Edith Hale Harkness, executors of the Last Will and Testament of William L. Harkness, deceased, shall prosecute said writ to effect, and answer all damages and costs if they fail to make said writ good, then this obligation shall be void, otherwise the same shall be and remain in full force and virtue.

THE NEW YORK TRUST COMPANY AND
EDITH HALE HARKNESS,

*Executors Last Will & Testament of
William L. Harkness.*

By J. S. MAXWELL,
Vice-Pres.

NATIONAL SURETY COMPANY,

By H. E. EMMETT,
Resident Vice-President.

Attest:

N. V. TYNAN,
Resident Assistant Secretary.

STATE OF NEW YORK,
County of New York, ss:

On this — day of September, 1921, before me personally came the within named —, to me known, and known to me to be the individual described in and who executed the within bond and acknowledged that — executed the same.

82 [Endorsed:] L. 25-19. District Court of United States, Southern District of New York. The New York Trust Company and ano., etc., Plaintiffs-Appellants, against William H. Edwards, collector of the United States Internal Revenue for the Second District of New York, Defendant-Respondent. Bond on Appeal. Surety, National Surety Company. —, Attorney for —. I approve of the written Bond, and of the sufficiency of the surety thereon. 9/13/21. C. M. Hough, U. S. C. J.

Affidavit, Acknowledgment, and Justification by Guarantee or Surety Company.

STATE OF NEW YORK,
County of New York, ss:

On this 9th day of September, 1921, before me personally came H. E. Emmett, known to me to be the Resident Vice-President of National Surety Company, the corporation described in and which executed the foregoing bond of The New York Trust Company and ano., etc., as surety and who, being by me duly sworn, did depose and say that he resides in the City of New York, State of New York; that he is the Resident Vice-President of said Company, and knows the corporate seal thereof; that the said National Surety Company is duly incorporated under the laws of the State of New York, that said Company has complied with the provisions of the Act of Congress of August 13, 1894, that the seal affixed to the within Bond of The New York Trust Company and ano., etc., is the corporate seal of said National Surety Company, and was thereto affixed by authority of the Board of Directors of said Company, and that he signed his name thereto by like authority as Resident Vice-President of said Company, and that he is acquainted with N. V. Tynan, and knows him to be the Resident Assistant Secretary of said Company; and that the signature of said N. V. Tynan, subscribed to said Bond is in the genuine handwriting of said N. V. Tynan, and was thereto subscribed by order and authority of said Board of Directors, and in the presence of said deponent; and that the assets of said Company, unencumbered and liable to execution

exceed its debts and liabilities of every nature whatsoever, by more than the sum of ten million dollars.

H. E. EMMETT,
(Deponent's Signature.)

Signed, sworn to, and acknowledged before me this 9th day of September, 1921.

F. B. FIELDS,
Notary Public, &c.

STATE OF NEW YORK,
County of New York, ss:

On this 10th day of September, 1921, before me personally came J. S. Maxwell; to me known, who, being by me duly sworn, did depose and say that he resides in Forest Hills, L. I.; that he is the Vice President of the New York Trust Company the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Trustees of the said corporation, and that he signed his name to the said instrument by like order.

VERN R. FOLEY, [SEAL]
Notary Public, New York County.

Clerk's No. 380, Register's No. 2—2.
Commission expires March 30, 1922.

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L. 25-19.

Writ of Error.

UNITED STATES OF AMERICA, ss:

The President of United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, or some of you, between The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, plaintiffs, against William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, defendant, a manifest error hath happened, to the great damage of the said The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, plaintiffs, as is said and appears by their complaint. We being willing that such error, if any hath been made, should be duly corrected and full and speedy justice done to the parties aforesaid in its behalf, Do Command you, if judgment be therein given that then under your seal, distinctly and openly, you send the record

and proceedings aforesaid with all things concerning the same to the Supreme Court of the United States, at the City of Washington, District of Columbia, together with this writ, so that you have the same at the said place, before the Supreme Court of the United States aforesaid on the 8th day of October, 1921, that the record and proceedings aforesaid being inspected, said Supreme Court of the United States may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the Honorable William Howard Taft, Chief Justice of the United States, this 10th day of Sept., 1921, in the year of our Lord one thousand nine hundred and twenty-one and of the Independence of the United States the one hundred and forty sixth.

[SEAL.]

ALEX. GILCHRIST, JR.,
Clerk of the District Court of the United
States of America for the Southern
District of New York, in the Second
Circuit.

The foregoing writ is hereby allowed.

J. M. MAYER,

U. S. District Judge.

[Endorsed:] United States District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, Plaintiffs, against William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, Defendant. Writ of Error. Murray, Prentice & Aldrich, Attorneys for Plaintiff-in-error, 37 Wall Street, New York.

By the Honorable Julius M. Mayer, One of the Judges of the District Court of the United States for the Southern District of New York, in the Second Circuit, to William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, Greeting:

You are hereby cited and admonished to be and appear before the United States Supreme Court to be holden in the City of Washington, on the 8th day of October 1921, pursuant to a writ of error filed in the clerk's office of the District Court of the United States for the Southern District of New York, wherein The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, are plaintiffs-in-error, and you are defendant-in-error, to show cause, if any there be, why the proceedings and judgment in the said writ of error mentioned, should not be corrected and why speedy justice should not be done in that behalf.

Given under my hand in the Borough of Manhattan, in the City of New York, in the District and Circuit above named, this 10th day

of September, in the year of our Lord one thousand nine hundred and twenty-one and of the Independence of the United States the one hundred and forty-sixth.

J. M. MAYER,

Judge of the District Court of the United States for the Southern District of New York, Second Circuit.

88 [Endorsed:] United States District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, Plaintiffs, against William H. Edwards, Collector of United States Internal Revenue for the Second District of New York, Defendant. Citation on Appeal. Murray, Prentice & Aldrich, Attorneys for Plaintiffs, 37 Wall Street, New York.

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Stipulation on Appeal Record.

United States District Court, Southern District of New York.

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS, Executors of the Last Will and Testament of William L. Harkness, Deceased, Plaintiffs,

vs.

WILLIAM H. EDWARDS, Collector of United States Internal Revenue for the Second District of New York, Defendant.

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated — —, — —.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Plaintiffs.

WM. HAYWARD,
U. S. Attorney, Attorney for Deft.

90 [Endorsed:] United States District Court, Southern District of New York. The New York Trust Company and Edith Hale Harkness, Executors of the Last Will and Testament of William L. Harkness, deceased, plaintiffs, vs. William H. Edwards, Collector of United States Internal Revenue for the Second Dist. of New York, Defendant. Stipulation as to Correctness of Appeal Record. Record certified — —, 191-. — —, Clerk. — —, Attorney for — —, Borough of Manhattan, City of New York.

91 UNITED STATES OF AMERICA,
Southern District of New York, ss:

THE NEW YORK TRUST COMPANY and EDITH HALE HARKNESS, Ex-
ecutors of the Last Will and Testament of William L. Harkness,
Deceased, Plaintiffs,

vs.

WILLIAM H. EDWARDS, Collector of United States Internal Revenue
for the Second District of New York, Defendant.

I, Alexander Gilchrist, Jr., Clerk of the District Court of the
United States of America for the Southern District of New York,
do hereby Certify that the foregoing is a correct transcript of the
record of the said District Court in the above-entitled matter as agreed
on by the parties.

In testimony whereof, I have caused the seal of the said Court to
be hereunto affixed, at the City of New York, in the Southern District
of New York, this thirteenth day of September in the year of our
Lord one thousand nine hundred and twenty-one and of the In-
dependence of the said United States the one hundred and forty-sixth.

[Seal of the District Court of the United States, Southern
District of N. Y.]

ALEX. GILCHRIST, JR.,
Clerk.

92 [Endorsed:] United States District Court, Southern Dis-
trict of New York. The New York Trust Company and
Edith Hale Harkness, Executors of the Last Will and Testament of
William L. Harkness, Deceased, Plaintiffs, against William H. Ed-
wards, Collector of United States Internal Revenue for the Second
District of New York, Defendant. Certified Copies of Papers on
Appeal. Murray, Prentice & Aldrich, Attorneys for plaintiffs, 37
Wall Street, New York.

Endorsed on cover: File No. 28,491. S. New York D. C. U. S.
Term No. 536. The New York Trust Company and Edith Hale
Harkness, executors of the last will and testament of William L.
Harkness, deceased, plaintiffs in error, vs. William H. Edwards, col-
lector of United States internal revenue for the second district of
New York. Filed September 15th, 1921. File No. 28,491.

(4684)



OCT 4 1921

JAMES D. MAHER,
CLERK

IN THE
Supreme Court of the United States,

OCTOBER TERM, A. D., 1921.

No. 535.

JOHN D. ROCKEFELLER,
Plaintiff-in-Error,
against

UNITED STATES OF AMERICA,
Defendant-in-Error.

MOTION TO ADVANCE.

GEORGE WELWOOD MURRAY,
Counsel for Plaintiff-in-Error.

IN THE
Supreme Court of the United States,

OCTOBER TERM, A. D., 1921.

No. 535.

JOHN D. ROCKEFELLER,
Plaintiff-in-Error,
against

UNITED STATES OF AMERICA,
Defendant-in-Error.

MOTION TO ADVANCE.

Now comes John D. Rockefeller, plaintiff-in-error, and moves the Court that this cause be advanced on the docket and set down for hearing on October 10, 1921, immediately following the hearing of the argument in *United States v. Phellis*, No. 810, October Term, 1920.

Statement of Facts.

The writ of error in this cause is brought to review the final judgment of the United States District Court for the Southern District of New York for the plaintiff in the amount of Three hundred eighty-three thousand,

eight hundred ninety-one and 59/100 dollars (\$383,891.59), including interest and costs, entered upon an order sustaining the plaintiff's demurrer to the affirmative defense contained in the amended answer, granting the plaintiff's motion for judgment on the pleadings, and overruling the defendant's motion for judgment on the pleadings.

The action was brought to recover the amount claimed to be due under the Income Tax Law of 1913 as a tax on the excess of the market value over the par value of certain shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by the defendant in 1915, when the pipe line properties of The Prairie Oil & Gas Company and The Ohio Oil Company were transferred to the pipe line companies, and pursuant to prior agreement, the stock of the pipe line companies was issued or distributed to the stockholders of the oil companies.

The fundamental question is whether the shares of stock of the pipe line companies received by the plaintiff-in-error constituted income within the meaning of the Income Tax Law of 1913 and the Sixteenth Amendment. The theory upon which the suit was brought was that the issue or distribution of these shares of stock constituted a dividend, and that under the decisions of this Court in *Lynch v. Hornby*, 247 U. S. 339, and *Peabody v. Eisner*, 247 U. S. 347, the receipt thereof constituted the receipt of taxable income.

The plaintiff-in-error contends that the transaction whereby the pipe line properties were separated from the other business of the oil companies and transferred to the pipe line companies, and the stock of the pipe line companies was issued or distributed to the stockholders of the oil companies, did not constitute the payment of a dividend, and that thereby the plaintiff-in-error received no income under the rules and principles established by this Court in *Towne v. Eisner*, 245 U. S. 418, *Southern Pacific Co. v. Lowe*, 247 U. S. 330, *Lynch v. Turrish*, 247 U. S. 221, *Eisner v. Macomber*, 252 U. S. 189, and other cases.

United States v. Phellis, No. 810, October Term, 1920, has been set for argument on October 10, 1921. This is an action brought in the Court of Claims to recover from the United States the amount of certain payments made under protest, duress and compulsion pursuant to assessment under the Income Tax Law of 1913, upon the market value of certain shares of stock of E. I. du Pont de Nemours & Company, a Delaware corporation, received by the claimant (defendant-in-error) in 1915 when all of the assets of the E. I. du Pont de Nemours Powder Company, a New Jersey corporation, were transferred to the Delaware corporation in consideration of cash, debenture stock and common stock of the Delaware corporation, the common stock of which was distributed by the New Jersey corporation to its stockholders, pro rata, so that each stockholder received two shares of stock of the Delaware corporation for each

share of stock of the New Jersey corporation held by him.

It is stated in the papers filed upon the motion to advance made by the United States in *United States v. Phellis* that the Government contends that the distribution of the stock of the Delaware corporation was a distribution in specie of corporate property and therefore taxable income under the decisions of this Court in *Lynch v. Hornby*, 247 U. S. 339, and *Peabody v. Eisner*, 247 U. S. 347, and that the claimant bases his suit on the ground that the distribution was a stock dividend and was not taxable under the decisions of this Court in *Towne v. Eisner*, 245 U. S. 418, and *Eisner v. Macomber*, 252 U. S. 189.

It is clear that the questions presented in our case and in *United States v. Phellis* are very similar, and we respectfully suggest that it is proper that they should be set for hearing and argued at the same time. Furthermore, the questions arising in our case directly affect the administration of the revenue, and are of grave importance, and we conceive it to be in the public interest that the case should be advanced and set down for hearing at an early date.

While the amount involved in the particular case is relatively small, the total amount of payments made or taxes claimed by reason of the receipt of the stock referred to, and distributions of the same general nature by other corporations, is very considerable. In many such cases the Government has collected considerable

sums of money from taxpayers, and this money should be refunded promptly if the collection was illegal. In other such cases payment by taxpayers has been withheld pending a judicial determination of their tax liability, and it is to the interest of the Government that the question be adjudicated promptly.

The understanding between counsel representing the Government and the taxpayers in this case and in *The New York Trust Company, et. al. v. Edwards*, No. 536, under which they were argued together in the District Court, and simultaneously carried to this Court by writ of error, was that neither should obtain precedence over the other and that both should be argued at the same time in this Court.

GEORGE WELWOOD MURRAY,
Counsel for Plaintiff-in-Error.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Plaintiff-in-Error.

The defendant-in-error joins in the request that the above-entitled cause be advanced upon the docket and set down for hearing by this Court on October 10, 1921, immediately following the hearing of the argument in *United States v. Phellis*, No. 810, October Term, 1920.

Solicitor General.



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JAMES D. MAHER,
CLERK

IN THE
Supreme Court of the United States,

OCTOBER TERM, A. D., 1921.

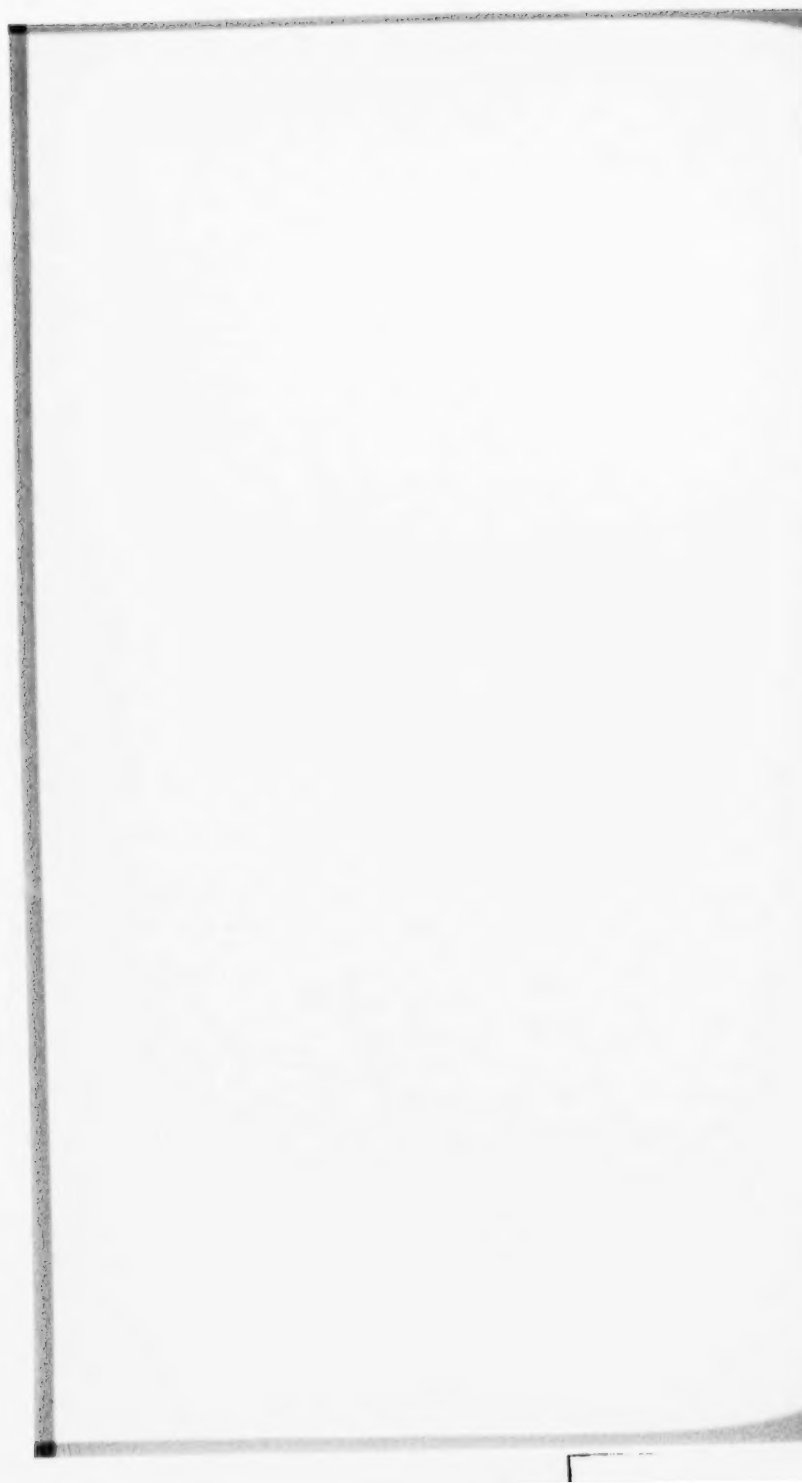
No. 536.

THE NEW YORK TRUST COMPANY and EDITH
HALE HARKNESS, Executors of the last will and
testament of William L. Harkness, deceased,
Plaintiffs-in-Error,
against

WILLIAM H. EDWARDS, Collector of United States
Internal Revenue for the Second District of the State
of New York,
Defendant-in-Error.

MOTION TO ADVANCE.

GEORGE WELWOOD MURRAY,
Counsel for Plaintiffs-in-Error.



IN THE
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OCTOBER TERM, A. D., 1921.

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MOTION TO ADVANCE.

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of William L. Harkness, deceased, plaintiffs-in-error,
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docket and set down for hearing on October 10, 1921, im-
mediately following the hearing of the argument in
United States v. Phellis, No. 810, October Term, 1920.

Statement of Facts.

The writ of error in this cause is brought to review the final judgment of the United States District Court for the Southern District of New York dismissing the complaint entered upon an order sustaining the demurrer of the defendant (defendant-in-error here) to the amended complaint.

The action was brought to recover the amount of two certain payments aggregating \$44,413.91 made under protest, duress and compulsion pursuant to assessments under the Income Tax Law of 1913, first, upon the par value and, subsequently, upon the excess of the market value over the par value of certain shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company received by the testator of the plaintiffs (plaintiffs-in-error here) in 1915, when the pipe line properties of The Prairie Oil & Gas Company and The Ohio Oil Company were transferred to the pipe line companies, and pursuant to prior agreement, the stock of the pipe line companies was issued or distributed to the stockholders of the oil companies.

The fundamental question is whether the shares of stock of the pipe line companies received by the testator of the plaintiffs-in-error constituted income within the meaning of the Income Tax Law of 1913 and the Sixteenth Amendment. The theory upon which the assessments were made was that the issue or distribution of these shares of stock constituted a dividend, and that under the decisions of this Court in *Lynch v. Hornby*,

247 U. S. 339, and *Peabody v. Eisner*, 247 U. S. 347, the receipt thereof constituted the receipt of taxable income. The plaintiffs-in-error contend that the transaction whereby the pipe line properties were separated from the other business of the oil companies and transferred to the pipe line companies, and the stock of the pipe line companies was issued or distributed to the stockholders of the oil companies, did not constitute the payment of a dividend, and that thereby the testator of plaintiffs-in-error received no income under the rules and principles established by this Court in *Towne v. Eisner*, 245 U. S. 418, *Southern Pacific Co. v. Lowe*, 247 U. S. 330, *Lynch v. Turrish*, 247 U. S. 221, *Eisner v. Macomber*, 252 U. S. 189, and other cases.

United States v. Phellis, No. 810, October Term, 1920, has been set for argument on October 10, 1921. This is an action brought in the Court of Claims to recover from the United States the amount of certain payments made under protest, duress and compulsion pursuant to assessment under the Income Tax Law of 1913, upon the market value of certain shares of stock of E. I. du Pont de Nemours & Company, a Delaware corporation, received by the claimant (defendant-in-error) in 1915 when all of the assets of the E. I. du Pont de Nemours Powder Company, a New Jersey corporation, were transferred to the Delaware corporation in consideration of cash, debenture stock and common stock of the Delaware corporation, the common stock of which was distributed by the New Jersey corporation to its stock-

holders, pro rata, so that each stockholder received two shares of stock of the Delaware corporation for each share of stock of the New Jersey corporation held by him.

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It is clear that the questions presented in our case and in *United States v. Phellis* are very similar, and we respectfully suggest that it is proper that they should be set for hearing and argued at the same time. Furthermore, the questions arising in our case directly affect the administration of the revenue, and are of grave importance, and we conceive it to be in the public interest that the case should be advanced and set down for hearing at an early date.

While the amount involved in the particular case is relatively small, the total amount of payments made or taxes claimed by reason of the receipt of the stock referred to, and distributions of the same general nature

by other corporations, is very considerable. In many such cases the Government has collected considerable sums of money from taxpayers, and this money should be refunded promptly if the collection was illegal. In other such cases payment by taxpayers has been withheld pending a judicial determination of their tax liability, and it is to the interest of the Government that the question be adjudicated promptly.

The understanding between counsel representing the Government and the taxpayers in this case and in *United States v. Rockefeller*, No. 535, under which they were argued together in the District Court, and simultaneously carried to this Court by writ of error, was that neither should obtain precedence over the other and that both should be argued at the same time in this Court.

GEORGE WELWOOD MURRAY,
Counsel for Plaintiffs-in-Error.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Plaintiffs-in-Error.

The defendant-in-error joins in the request that the above-entitled cause be advanced upon the docket and set down for hearing by this Court on October 10, 1921, immediately following the hearing of the argument in *United States v. Phellis*, No. 810, October Term, 1920.

Solicitor General.

OCT 10 1921

WM. R. STANB

CLERK

NOS. 536 AND 535.

Supreme Court of the United States,

OCTOBER TERM, A. D., 1921.

THE NEW YORK TRUST COMPANY and another, Executors of WILLIAM L. HARKNESS, deceased,

Plaintiffs-in-Error,

vs.

WILLIAM H. EDWARDS, Collector of Internal Revenue,

Defendant-in-Error.

JOHN D. ROCKEFELLER,

Plaintiff-in-Error,

vs.

UNITED STATES OF AMERICA,

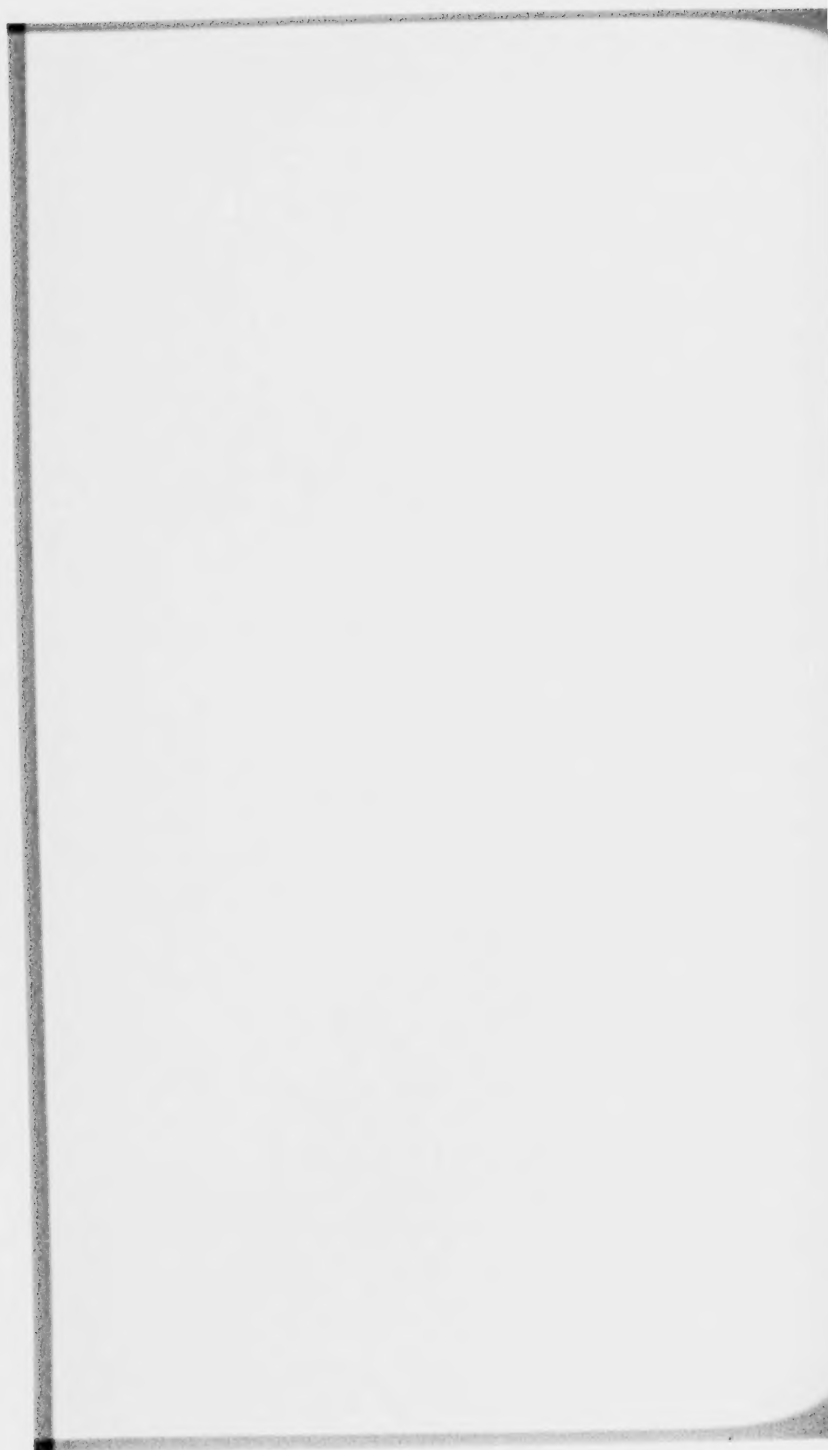
Defendant-in-Error.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR
THE SOUTHERN DISTRICT OF NEW YORK.

Brief and Argument for Plaintiffs-in-Error.

GEORGE WELWOOD MURRAY,
HARRISON TWEED,

Counsel for Plaintiffs-in-Error.



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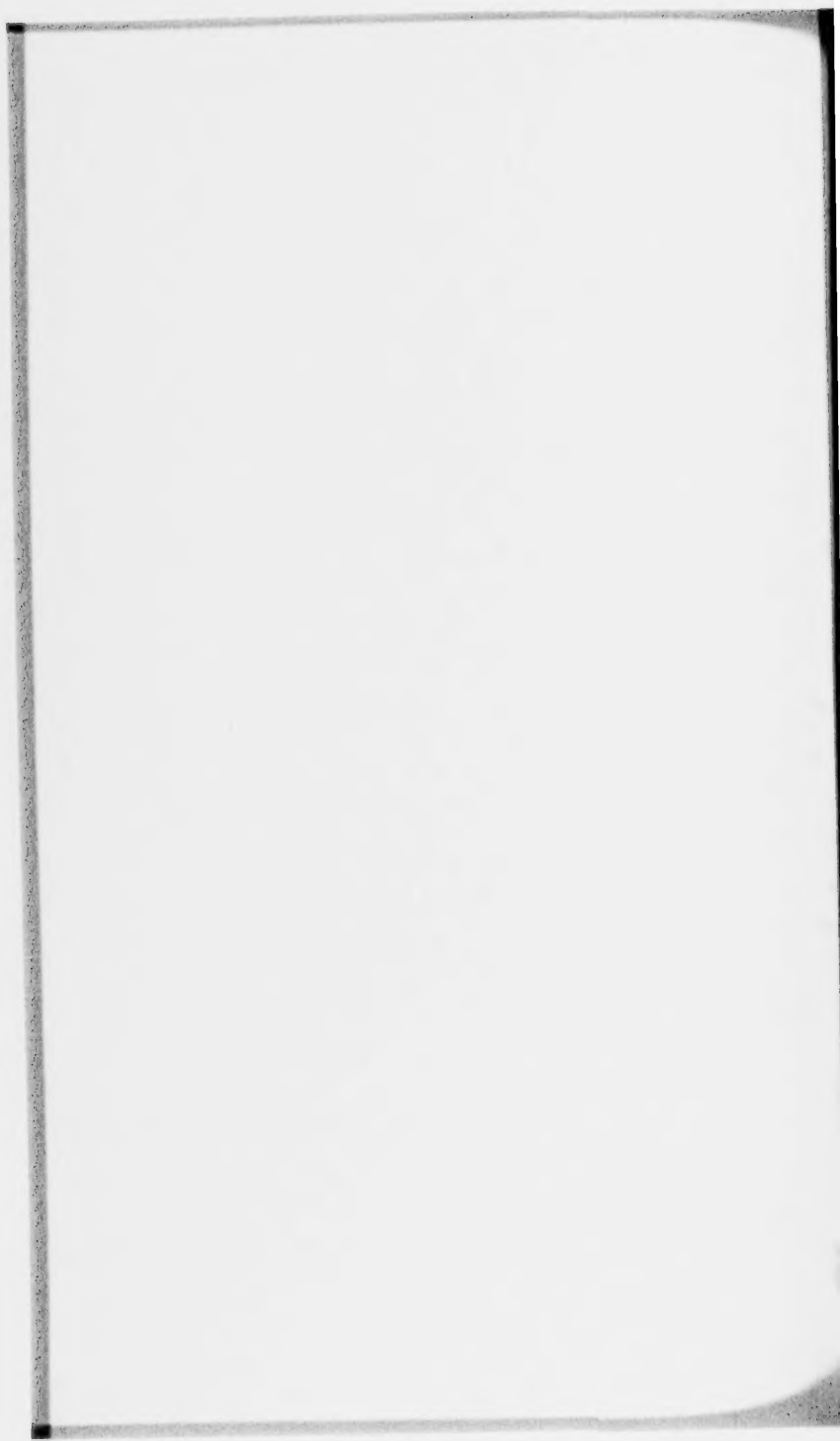
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IN THE
Supreme Court of the United States
October Term A. D., 1921

THE NEW YORK TRUST COMPANY and EDITH
HALE HARKNESS, Executors of the Last
Will and Testament of William L. Hark-
ness, deceased,

Plaintiffs-in-Error,

against

WILLIAM H. EDWARDS, Collector of United
States Internal Revenue for the Second
District of the State of New York,

Defendant-in-Error.

No. 536.

JOHN D. ROCKEFELLER,

Plaintiff-in-Error,

against

UNITED STATES OF AMERICA,

Defendant-in-Error.

No. 535.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF NEW YORK.

STATEMENT OF THE CASE.

State of the Record: *The New York Trust Company,*
et al. v. Edwards, No. 536, is an action to recover
from the defendant (defendant-in-error here) the

amount of certain payments made under protest, duress and compulsion, pursuant to assessments under the Federal Income Tax Law of October 3, 1913, first, on the par value and, subsequently, on the excess of the market value over the par value of certain shares of stock of The Prairie Pipe Line Company and The Illinois Pipe Line Company, received by the testator of the plaintiffs (plaintiffs-in-error here) in 1915, pursuant to the corporate proceedings hereinafter described. A demurrer to the complaint was sustained. The plaintiffs stood by their declaration and the suit was dismissed. The case is brought here by a writ of error on the ground that the validity of an Act of Congress under the Constitution of the United States is involved.

The opinion of the Court below is found at folio 65 of the Record in No. 535 and at folio 58 of the Record in No. 536.

Rockefeller v. United States of America, No. 535, is an action to recover from the defendant (plaintiff-in-error here) an amount claimed to be due under the same Income Tax Law of 1913, as a tax on the excess of the market value over the par value of the shares of stock of the pipe line companies, received by the defendant in 1915, pursuant to the same corporate proceedings. The defendant set up an affirmative defense, asserting that no tax was due under the Income Tax Law, and that if it were so construed as to impose a tax in the premises, it would be unconstitutional and void. The plaintiff (defendant-in-error here) demurred to this af-

firmative defense and moved for judgment on the pleadings. The defendant made a cross-motion for judgment on the pleadings. The demurrer was sustained, the plaintiff's motion for judgment granted and the motion of the defendant denied. The defendant stood by his affirmative defense and judgment was entered for the plaintiff. The case is brought here by a writ of error on the ground that the validity of an Act of Congress under the Constitution of the United States is involved.

The Issue Raised.—In *The New York Trust Company, et al. v. Edwards*, No. 536, the question is whether the stockholders of a corporation have received "income derived from dividends" within the meaning of the Income Tax Law of 1913 and "incomes" within the meaning of the Sixteenth Amendment to the extent either of the par value or the market value of the stock received, when a corporation which has been conducting two distinct lines of business is compelled by business necessity to transfer one of those lines of business to a newly organized corporation, and, in order that each stockholder may retain his stockholder's interest in the entire enterprise undiminished and unimpaired, makes the transfer upon the condition that the stock of the new corporation shall be issued or distributed to the stockholders of the original company.

In *Rockefeller v. United States of America*, No. 535, the question is the same, except that it is limited to the excess of the market value over the par value of the stock received.

The Jurisdiction of the Supreme Court. The amended complaint in No. 536 (Rec. Fol. 26) and the affirmative defense in the amended answer in No. 535, (Rec. Fol. 34) alleged that the Act of Congress under which the taxes in question were assessed or sued for, was invalid and void, in so far as the same might be asserted to confer power to make such assessments or to sustain a suit in this: That the tax was not apportioned among the States according to population as required by Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, of the Constitution of the United States, and that the tax assessed or sued for under the Act of Congress was not a tax on "incomes" within the meaning of the Sixteenth Amendment to the Constitution of the United States. Under the rule of *Towne v. Eisner*, 245 U. S. 418, plaintiffs-in-error in No. 536 and plaintiff-in-error in No. 535 were entitled to sue out writs of error for a review in this Court, of the judgments of the District Court. It is immaterial that there is also involved the question of the construction of the Act of Congress. While the Government keeps the money or asserts in the courts its right to receive money, "it opens the question whether the act construed as it has construed it can be maintained."

The Admitted Facts: The facts are fully set out in the amended complaint in No. 536 (Rec. Fol. 4) and the amended answer in No. 535 (Rec. Fol. 16). Briefly, they are as follows:

During 1914, and prior thereto, the business of each

of the oil companies consisted of two distinct parts, the first consisting of the producing and manufacturing of petroleum, and the second consisting of the transportation of petroleum through pipe lines. In June, 1914, it was judicially determined by this Court in *United States v. Ohio Oil Company*, and *United States v. Prairie Oil & Gas Company*, 234 U. S. 548, that this second part of the business of these particular companies, among others, was subject to the supervision and regulation of the Interstate Commerce Commission, and in September, 1914, the first part of their businesses became subject to the supervision of the Federal Trade Commission by virtue of the Federal Trade Commission Act. (38 Stat. 717.)

In view of this conflict of Federal authority in the regulation of the business of the oil companies, and the confusion which must inevitably have arisen not only in the methods of accounting but also in the conduct of business, because each of the Commissions would have considered itself authorized and would have undertaken to supervise and regulate the entire business, the transfer of the pipe line property and business of each of the oil companies to a new corporation, organized for the exclusive purpose of taking over the same was, on advice of counsel, deemed necessary.

In the case of The Ohio Oil Company an additional consideration rendered such a transfer advisable, in that the tax imposed by Section 5487 of the Ohio General Code upon the gross receipts of companies engaged in

transporting oil by pipe lines, applied to all of the gross receipts, whether derived from that business or any other business in which the corporation was engaged.

The charter of The Prairie Oil & Gas Company did not permit that company to hold the stock of The Prairie Pipe Line Company, and under the statutes of the State in which it was organized an amendment of the charter permitting it to do so could not be obtained.

In the case of The Ohio Oil Company, it was deemed inadvisable that the stock of The Illinois Pipe Line Company should be held by The Ohio Oil Company. If it held the stock there would always be the possibility of conflict between the two commissions.

Accordingly, the plan adopted by each of the oil companies contemplated that all of the stock of the pipe line companies should be issued or distributed to the stockholders of the oil companies. Pursuant thereto, the pipe line properties of The Prairie Oil & Gas Company were conveyed to the pipe line company under a contract which obligated the pipe line company to issue its stock directly to the stockholders of the oil company. In the case of The Ohio Oil Company, the contract obligated the pipe line company to issue its stock to the oil company, but, in the very resolution of the Board of Directors of the oil company, by which the contract with the pipe line company was made, the Board directed a distribution of the stock of the pipe line company among its own stockholders, and the certificate for all of the stock of the pipe line company, which was orig-

inally issued to the oil company, was immediately surrendered for transfer, and new certificates were issued and distributed to the stockholders of the oil company. These proceedings were had in 1915. As determined by the market values of the stock of the oil companies and the pipe line companies respectively, the pipe line properties constituted in the one case, approximately one-half, and in the other case, approximately one-quarter, of the entire enterprise.

Of course, the segregation of the pipe line property involved in each case the elimination thereof as an asset of the appropriate oil company and its entry as an asset of the appropriate pipe line company. No entry was made in the dividend account of either of the oil companies on account of the issue or distribution of the stock of the pipe line companies. It happened that at the time of the transfer of the pipe line properties the books of each of the oil companies showed a surplus. The market value of the stockholdings of a stockholder of neither oil company was greater after the transfer of the pipe line properties and the issue and distribution to him of the stock of the pipe line companies than before. Neither the plaintiffs-in-error in No. 536 nor their testator, nor the plaintiff-in-error in No. 535 has sold any of the stock of the pipe line companies.

The foregoing are the controlling facts on the main issue. It is also the fact that all or at least a substantial part of the pipe line property which was transferred by The Ohio Oil Company was owned by it on March

1, 1913, and that it did not increase in value, at least not to the extent of the par value of the stock of the pipe line company, between that date and the date of the transfer, and that approximately seventy-five per cent of the pipe line property transferred by The Prairie Oil & Gas Company was owned by it on March 1, 1913, and was acquired with money paid out of funds composed in part of the proceeds of the sale of stocks and bonds and in part of earnings, and that it did not increase in value, at least not to the extent of the par value of the stock of the pipe line company between that date and the date of the transfer.

In *The New York Trust Company, et al., v. Edwards*, No. 536, additional facts are that the testator of plaintiffs-in-error did not include in his income tax return for the year 1915 any part of the value of the stock of the pipe line companies received by him. Thereafter, and on or about August 6, 1917, the defendant-in-error demanded a tax upon the par value of those shares of stock and subsequently, on or about June 30, 1919, the defendant-in-error demanded a further tax upon the excess of the market value at the date of receipt over the par value of the shares of stock. Both demands were complied with under protest, duress and compulsion, and appeals were taken to the Commissioner of Internal Revenue and repayment and refund demanded. In the case of the tax upon the par value of the stock the appeal was taken on or about November 10, 1917, and was disallowed on or about April 22, 1919.

In the case of the tax upon the difference between the excess of the market value over the par value of the stock, the appeal was taken on or about March 25, 1920, and the Commissioner of Internal Revenue had failed and neglected to decide the same at the time that the action was commenced on March 1, 1921.

In *Rockefeller v. United States of America*, No. 535, additional facts are that the plaintiff-in-error did not include in his income tax return for the year 1915 any part of the value of the stock of the pipe line companies received by him. Thereafter, and on or about September 14, 1917, Mark Eisner, as Collector of Internal Revenue for the Third District of New York, demanded a tax upon the par value of the shares of stock, which demand was complied with under protest, duress and compulsion. On March 7, 1918, an appeal was taken to the Commissioner of Internal Revenue and repayment and refund demanded. The appeal was disallowed on or about May 24, 1919. It does not appear in the record that any further tax was assessed upon the excess of the market value over the par value of the stock, although it is alleged and admitted that a demand for the amount now claimed was made. The fact is that no such assessment was made within three years after the tax return for the year 1915 was due, and the plaintiff-in-error refused to comply with the request of the Commissioner of Internal Revenue that he waive the statute of limitations imposed by Section E of the Income Tax Law of 1913 (See Appendix A, page 93).

Thereupon this suit was brought to recover the amount of the alleged additional tax claimed to be due.—

The Provisions of the Statute: The applicable parts of the Income Tax Law of 1913 are found in 38 Stat. 166, Ch. 16, Part 1, Section II:

“A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States whether residing at home or abroad and to every person residing in the United States though not a citizen thereof, a tax of one per centum per annum upon such income except as hereinafter provided * * *

Subdivision 2. In addition to the income tax provided under this section (herein referred to as the normal income tax) there shall be levied, assessed, and collected upon the net income of every individual an additional income tax (herein referred to as the additional tax) of * * *

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce or sales or dealings in property whether real or personal growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities or the transaction of any lawful busi-

ness carried on for gain or profit or gains or profits and income derived from any source whatever including the income from but not the value of property acquired by gift, bequest, devise or descent * * *

That in computing the net income for the purpose of the normal tax there shall be allowed as deductions: * * * seventh: the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association or insurance company which is taxable upon its net income as hereinafter provided."

The Constitutional Provisions:

"Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, * * *." (Art. I, Sec. 2, Cl. 3.)

"No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." (Art. I, Sec. 9, Cl. 4.)

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." (Sixteenth Amendment.)

The Errors Assigned. The errors assigned include the following:

1: In No. 536 the sustaining of the demurrer and dismissal of the suit. In No. 535 the sustaining of the demurrer, the granting of the defendant-in-error's motion for judgment on the pleadings and the denial of the plaintiff-in-error's motion for judgment on the pleadings.

2: In both cases the holding of the Court below that the Act of Congress which was asserted to confer power to make the assessments and to compel the payment of the taxes, or to bring the suit was not in violation of Article 1, Section 2, Clause 3, or Article 1, Section 9, Clause 4 of the original Constitution of the United States.

3: In both cases the holding of the Court below that the shares of stock of the pipe line companies constituted income and were subject to taxation as income within the meaning of the Sixteenth Amendment to the Constitution of the United States.

4: In both cases the holding of the Court below that the shares of stock of the pipe line companies were subject to taxation under the Act of Congress of October 3, 1913.

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One. The fact is that the transaction was purely a capital transaction, the substance of which was merely an alteration in the form of the stockholder's capital interest—an exchange of one form of capital interest for another—from which no income was derived. page 19

Two. The rules and principles established by this Court and applied by it in the *Towne* and *Macomber* cases prohibit a resort to metaphysics to establish the receipt of income in connection with a transaction which from the point of view of the corporation was a necessary separation of its two lines of business, and from the point of view of the stockholder was a mere change in the form of his capital investment. page 28

I. Regard must be had to the substance and entirety of the transaction. page 28

II. The meaning to be attached to the word "income" is not that ascribed to it by dictionaries or economists but is, on the contrary, the meaning in which it is commonly used and understood. page 32

III. There are three essential elements of income: (a) gain; (b) separated from the capital, and (c) realized by the recipient. page 34

IV. In the case of a stockholder, income is not realized unless and until something has been freed from corporate control and business risks and transferred to the absolute ownership of the stockholder. page 35

V. The *Towne* case illustrates the application of the foregoing rules and principles to facts very similar to the facts in the case at bar and is conclusive that the stock of the pipe line companies did not

constitute income within the meaning of the Income Tax Law of 1913. page 38

VI. The opinion of the Court in the Macomber case is simply a more thorough analysis of the facts and principles which controlled the decision in the Towne case, and an extension of that decision to cover the construction of the Sixteenth Amendment. page 46

VII. The Macomber case is conclusive that the stock of the pipe line companies did not constitute income within the meaning of the Sixteenth Amendment. page 52

VIII. Any dissent in the Macomber case was based upon considerations which have no application in the case at bar. page 67

Three. The stock of the pipe line companies did not become a part of the assets of the oil companies. page 68

Four. There is a fundamental distinction between the distribution to stockholders of liquid treasury assets on the one hand, and, on the other hand, the proceeds of the disposition of business plant constituting an integral part of the enterprise. page 70

Five. No part of the cause of action of plaintiffs-in-error in No. 536 is barred by the provisions of Sections 3226 and 3227 of the Revised Statutes. page 82

ARGUMENT.

Introduction.

The claim of the Government is that the issue or distribution of the stock of the pipe line companies constituted "property dividends" paid by the oil companies to their stockholders, and that under *Peabody v. Eisner*, 247 U. S. 347, those stockholders received "income derived from dividends" within the intendment of the Income Tax Law of 1913 and "income" within the meaning of the Sixteenth Amendment.

There is no other basis on which the Government could rest its claim. There are only two ways in which a stockholder may receive income. One of them is by the receipt of dividends, and the other is by the realization of a gain or profit at the time that his investment becomes a closed transaction. In the case at bar no claim is made that any gain or profit was realized by the stockholders of the oil companies. The Government's entire conception of the transaction negatives the idea that there was a closed transaction, and there are no facts in the case upon which a claim that a gain or profit was realized could be predicated.

Very briefly, the facts are that each oil company had been carrying on two distinct lines of business and had accumulated a surplus; that circumstances arose which, practically speaking, necessitated that these two distinct lines of business thereafter be conducted by separate corporations; that one of the oil companies had not, and

could not obtain, charter power to hold the stock of a corporation conducting either of those lines of business, and that it was deemed inadvisable that the other oil company should do so; that therefore the interest of each stockholder in the entire enterprise which consisted of the two lines of business could be maintained without impairment only if he became the owner of his proportionate share of the stock of the new corporations; that accordingly pipe line companies were organized to which the pipe line businesses were transferred upon the condition that the stockholders of the oil companies should become the owners of the stock of the pipe line companies.

We think it is clear that, such being all of the facts, a claim that a stockholder of the oil companies received "income derived from dividends" within the intendment of the Income Tax Law of 1913 and "income" within the meaning of the Sixteenth Amendment, is thoroughly artificial and utterly unsound.

In the District Court the argument of the Government was limited to the contention that the stock of the pipe line companies became in effect a part of the assets of the oil companies and was distributed by them to their stockholders in such a manner that the distribution constituted a "property dividend" within the decision of this Court in *Peabody v. Eisner*, 247 U. S. 347.

The learned Court below rejected this argument on the ground that in the case of The Prairie Oil & Gas Company the pipe line properties were con-

veyed under a contract which obligated the pipe line company to issue its stock directly to the stockholders of the oil company, and that in the case of The Ohio Oil Company, although the contract obligated the pipe line company to issue its stock to the oil company, nevertheless in the very resolution of the Board of Directors of the oil company by which the contract with the pipe line company was made the Board directed a distribution of the stock of the pipe line company among the stockholders. Therefore, as the learned Court below expressed it neither of the oil companies "for any moment of time owned the pipe line shares as free assets."

We believe that the stock of the pipe line companies did not become a part of the assets of the oil companies, but we do not wish to be understood as resting our case upon that negative fact. There is no dispute that the stockholders of the oil companies received the stock of the pipe line companies. The question is whether the receipt of that stock constituted the receipt of income. Neither formalities nor technicalities can affect the solution of that question one way or the other.

All that we insist upon in this connection is that the transaction be viewed in its entirety and that regard be had to the fact that the transfer by necessity of the pipe line properties was the fundamental concern, and that the sole motive for and effect of the issue or distribution of the stock of the pipe line companies to the stockholders of the oil companies was the preservation of their stockholders' interest in the entire enterprise.

We apprehend that in this Court the Government may advance the proposition that the pipe line properties having been transferred to the pipe line companies and the stock of the pipe line companies having been issued or distributed to the stockholders of the oil companies—those stockholders should, for purposes of taxation, be treated as having received the pipe line properties themselves and a part of the surplus of the oil companies.

The short answer to this proposition is that it is simply the statement of an arbitrary conclusion. A stockholder does not own the assets of the corporation. To say that the transfer of the pipe line properties to the pipe line companies and the issue or distribution of the stock of the pipe line companies to the stockholders of the oil companies is the equivalent of a transfer of the pipe line properties directly to the stockholders is to beg the entire question. Further than that, and more important, it is to pervert the entire nature of the transaction—to convert into a distribution of surplus to stockholders, what was in purpose, in consummation and in result a transfer from one corporation to another of physical capital assets constituting a distinct line of business upon condition that the interest of the stockholders therein should be preserved—to metamorphosize a business readjustment of the ownership of corporate assets into a fictitious dividend.

The conception that the transfer of the pipe line properties could constitute a distribution of surplus sub-

stitutes mere bookkeeping entries for actualities. The fact that business plant constituting an integral part of the enterprise was transferred cannot be ignored. The reason is, not that a distribution of earnings may be disguised by making it in the form of property instead of cash, but that in the nature of things any distribution by a corporation of all of its property or of a part of its property which constitutes a distinct line of business (or of the proceeds of the disposition thereof) is something more than (something radically different from) a mere distribution of property, and, as has repeatedly been held in cases involving the relative rights of life tenant and remainderman, is not a return of income but a refundment of capital.

POINT ONE.

The fact is that the transaction was purely a capital transaction, the substance of which was merely an alteration in the form of the stockholder's capital interest—an exchange of one form of capital interest for another—from which no income was derived.

The mere statement of the facts indicates, without any analysis, that from the point of view of the corporation the transaction was a business readjustment involving the transfer of one of its two distinct lines of business to another corporation. It would therefore be purely accidental if it could be said that the stockholders received income as a result of that transaction.

In considering whether any such result can be attributed to the transaction its effect must be regarded from the point of view of a single stockholder and not from the point of view of the entire group of stockholders.

It is also essential that it be borne in mind that the interest of a stockholder is a capital interest in the surplus as well as in the capital of the corporation, since, in the words of this Court in *Eisner v. Macomber*, 252 U. S. 189, 219, "what is called the stockholder's share in the accumulated profits of the company is capital, not income," for the reason that "a stockholder has no individual share in accumulated profits nor in any particular part of the assets of the corporation, prior to dividend declared."

Let us assume that Smith owned 180 shares of stock of The Prairie Oil & Gas Company. Since there were 180,000 shares outstanding he had 1/1000 of the rights possessed by the whole group of stockholders. He had 1/1000 of the control—the right to 1/1000 of the dividends declared and the right to 1/1000 of the assets in liquidation. His interest was a capital interest with respect to surplus as well as capital. Those rights extended to both the oil manufacturing business and property and to the pipe line business and property. His shares of stock had an approximate market value of \$45,000. After the transfer of the pipe line properties Smith still held 1/1000 of the stock of the oil company and he had also 1/1000 of the stock of the pipe line com-

pany. He still retained through the oil company the same rights against the manufacturing business and property, and precisely the same rights against the pipe line business and property which he no longer had through the oil company he held through the pipe line company. The market value of his stock holdings remained unchanged. After the transfer as well as before every right which Smith had in, to or against either business or property was the derivative right of a stockholder. From the point of view of Smith what was the nature of this transaction?

In answering that question we shall state various supposititious cases. Our purpose in doing this, is not to argue by analogy, assuming the equivalency of cases which are not equivalents, but simply to bring out as clearly as possible by means of illustrations the true nature of the transaction consummated in the case at bar. We do not claim that the case at bar is precisely identical with any of the supposititious cases which we shall state. We do, however, confidently assert that in substance it is of exactly the same nature.

Suppose that all of the assets of The Prairie Oil & Gas Company, that being a Kansas corporation, had been transferred to a newly organized Kansas corporation with the same charter powers and the same number of shares of stock of the same par value, and that the new shares had been issued in exchange for the shares of the original company. The newly organized corporation would have had a surplus exactly equal to that which the

original company had. Under such circumstances it is not conceivable that the Government could claim a tax on the theory that the stockholder had received a dividend. It could not claim that the market value of all of the stock received constituted a dividend, and there would be no basis for saying that the market value of any particular portion of it constituted a dividend.

If, before the transfer, the surplus of The Prairie Oil & Gas Company had been transferred to capital account and additional stock issued against it, that would have constituted a stock dividend and the stockholders would not thereby have received any income. When, thereafter, the transfer of all the assets was made and the stock exchanged for the stock of the new corporation there could be no basis for a claim that a dividend had been paid, for there would have been no surplus either just before or just after the transfer.

If the additional stock had been issued coincidently with the transfer of the properties, instead of in advance, the nature of the transaction would have remained unchanged, and it would seem clear that a stockholder would not have received a taxable dividend.

If instead of a single new corporation two new corporations had been organized, to each of which, after the capitalization of the surplus, a distinct and complete business property of the old company had been transferred, that would not have metamorphosized the substance of the transaction. The only difference would have been in the detail that the capital investment of the stockholder would have been exchanged for or converted

into a capital investment in two corporations instead of in one. If the surplus had been capitalized as a part of, instead of prior to, the transfer, the nature of the proceeding would have been no different. Certainly, it could not have been suggested that the entire amount of the stock of both corporations constituted a dividend. And on what principle could it have been said that the stock of one, rather than the other, was a dividend?

If, then, in the case at bar each original company had organized two new corporations and transferred to one of them the oil manufacturing business and property, and to the other the pipe line business and property, and in connection with the transfers, agreements had been made that the stock of both new corporations should be issued or distributed to the stockholders of each original company, can there be any doubt that the transaction from the point of view of a stockholder of the original companies would have amounted to a conversion of his capital interest from a form represented by shares of stock in a single corporation owning two classes of property and carrying on two varieties of business into shares of stock of two new corporations each one of which was to own one of the classes of property and carry on one of the lines of business theretofore owned and carried on by each of the original companies, and that no suggestion would ever have been made that the stockholders had received a taxable dividend.

The substance of the transaction had in the case at bar is the same. The Government asserts and we

admit that the stockholders of the oil companies received something which they did not have before, namely, the stock of the pipe line companies. The Government lays great stress upon the fact, the existence of which we do not deny, that the pipe line properties were separated from the oil companies to the pipe line companies. It is an admitted fact that the oil companies ceased to carry on the pipe line business. If the stock of the pipe line companies received by the stockholders of the oil companies was something new and different then, by the same token the stock of the oil companies which the stockholders had after the transfer of the pipe line properties was something equally new and different. It was something just as new and different as if it had been the stock of a new corporation organized to own the oil manufacturing property and carry on the oil manufacturing business.

What happened was that when it was made plain to the stockholders of the oil companies that business necessity required that the two distinct lines of business each be conducted by a separate corporation the stockholders agreed to the transfer of the pipe line properties to newly organized corporations, upon the condition that they should receive in substitution for the interest which they had in that business as stockholders of the oil companies, proportionate interests as stockholders in the pipe line companies so that their capital interest in the entire enterprise might remain unimpaired.

Why should the Government claim a tax upon the

value of the stock of the pipe line companies any more than upon the value of the stock of the oil companies or of both companies? If the answer of the Government is that it was to the pipe line companies that the transfer of surplus was made, our reply is, first, that there was no transfer of surplus, that the transfer was of tangible capital business assets which, necessarily reduced, but did not transfer, the surplus; and, second, that the Government is not claiming a tax upon the basis of the transfer of surplus but upon the basis of the value of the stock of the pipe line companies which in principle and as a matter of dollars and cents is a totally different thing.

The surplus shown on the books of The Ohio Oil Company was reduced less than \$10,200,000 by the transfer of the pipe line properties. The valuation placed on the pipe line properties for the purposes of the transfer, and the par value of the stock issued by the pipe line companies was \$20,000,000. The Government implies that the distribution of this stock to the stockholders of the oil company constituted a distribution of the surplus of the oil company. Yet it seeks to tax those stockholders upon the market value of the stock which in the aggregate amounts to \$26,600,000. In the case of The Prairie Oil & Gas Company the surplus was reduced by less than \$21,300,000, the par value of the stock of the pipe line company was \$27,000,000, and its aggregate market value upon the basis of which the Government claims a tax was \$39,960,000.

We believe that what we have already said indicates that as a matter of principle the nature of the transaction, from the point of view of the stockholder, was a change in the form of his capital investment, and that any suggestion that the stockholder received a dividend must proceed from an utter misconception of what actually happened. Further than that the adoption of the Government's theory as a part of the system of taxation leads to absurd results.

Suppose that Smith purchases a hundred shares of stock of The Prairie Oil & Gas Company, before the transfer of the pipe line properties, at its then market value of \$450 a share. His capital investment is \$45,000. He receives 150 shares of stock of the pipe line company, having a market value of approximately \$22,500. The Government imposes a tax thereon upon the theory that the stock constitutes a dividend. After the transfer the stock of the oil company has a market value of \$225 a share, and the stock of the pipe line company has a market value of \$150 a share. During a subsequent year, when prices are low and taxes high, the oil company stock will presumably not be worth more than \$225 a share. If Smith sells it at that price, receiving \$22,500, he has a loss of \$22,500 which he may deduct from his income. It is true that he still has stock of the pipe line company which is presumably worth \$22,500, but the Government having taxed that as a dividend Smith's ownership of that stock is not to be taken into consideration in determining his profit or loss on the sale of the oil company stock.

The correct way to deal with the situation is to follow the rule laid down in Article 1568 of Treasury Department Regulations 45 (see Appendix B, page 94) for determining profit or loss upon the sale of stock received in exchange for stock of equal par value. That rule would attribute to the stock of the pipe line company the proportion of the cost of the original stock of the oil company which the market value of the stock of the pipe line company bears to the aggregate value of the stock of both companies after the transfer, at the same time marking down the cost of the stock of the oil company by the amount attributed to the stock of the pipe line company. The effect of applying this rule would be that a cost of \$150 a share would be attributed to the stock of the pipe line company and the cost of the stock of the oil company would be marked down to \$225 a share. Therefore, a sale of the stock of the oil company at \$225 a share would result in giving Smith no deductible loss. A sale at any higher price would under the rule of Article 1568 of the Regulations, constitute the realization of a taxable profit.

Our argument might very well end here, for we believe that as a matter of principle and logic and as a matter of correct practice under our system of taxation, we have already disposed of the controlling question in the case at bar. However, the Government, while apparently admitting in effect that our characterization of the nature of the transaction is correct, asserts that nevertheless the stockholder received income as a result of

the transaction. It is necessary, therefore, that we should go further and demonstrate that the proposition that by some refinement of reasoning such a transaction as was consummated in the case at bar may be deemed to constitute a taxable dividend has been repudiated by this Court, which has established rules and principles prohibiting a resort to metaphysics to obscure the truth and substance so that stockholders may be treated as having received something which in fact they have not received, and that this Court has in effect decided that the transaction involved in the case at bar constituted a capital transaction resulting in a mere change in the form of the stockholder's investment, from which no income was derived.

POINT TWO.

The rules and principles established by this Court and applied by it in the Towne and Macomber cases prohibit a resort to metaphysics to establish the receipt of income in connection with a transaction which from the point of view of the corporation was a necessary separation of its two lines of business, and from the point of view of the stockholder was a mere change in the form of his capital investment.

I. Regard must be had to the substance and entirety of the transaction.

The cases do more than merely state the rule that "regard must be had to the very truth of the matter, to substance and not to form." They apply that rule conscientiously, painstakingly and meticulously. A pertinent instance is the painstaking, instructive and convincing analysis of the nature and effect of a stock dividend in the opinion of this Court in *Eisner v. Macomber*, 252 U. S. 189. In *Towne v. Eisner*, 245 U. S. 418, a similar analysis was made in the opinion of Mr. Justice Holmes, speaking for the Court, more briefly, but with no less accuracy.

In *Southern Pacific Co. v. Lowe*, 247 U. S. 330, the situation presented to this Court was on its face the simple case of the payment of a dividend by a corporation to a stockholder, yet this Court examined the facts minutely and finding that the substance of things was that the stockholder had before March 1, 1913, the virtual ownership and possession of the earnings of the corporation subsequently distributed as a dividend, held that the payment of the dividend did not constitute taxable income of the stockholder. Precisely the same thing was done in *Gulf Oil Corporation v. Lewellyn*, 248 U. S. 71.

In *La Belle Iron Works v. United States*, 41 Supreme Court Reporter 528, the question was whether a corporation might in determining invested capital for the purpose of the excess profits tax for the year 1917 include the amount of the increase in value of its ore properties against which a stock dividend had been issued. The case turned upon the construction of the provisions of

the statute and it would seem that technically the argument of the tax payer was sound, but this Court refused to regard the question from a technical point of view and rejected the claim of the tax payer. Mr. Justice Pitney, delivering the opinion of the Court, said at page 531:

“But that distribution (the stock dividend), in substance and effect, was an internal transaction, in which the company received nothing from the stockholders any more than they received anything from it (see *Eisner v. Macomber*, 252 U. S. 189, 210, 211), and the old shares cannot be regarded as having been ‘paid in for’ the new ones within the meaning of Section 207 (a) (2), even were they ‘stocks’ within the meaning of that regulation, which is doubtful.”

In *Safe Deposit and Trust Company of Baltimore v. Miles* (U. S. D. C. So. Dist. of Md.) 273 Fed. 822, decided May 26, 1921, the question was whether a stockholder who had acquired rights to subscribe for additional shares of stock at less than the market value thereof and who had sold his rights should be required to include as income the full amount of the proceeds of the sale. The Court, page 823, said:

“The issue thus joined is whether the law will look to the transaction as a whole, or will close its eyes to everything that preceded the issue of the rights, and to all that came after their sale.”

The Court resolved the issue by regarding the trans-

action as a whole and holding that the amount of the taxable profits of the stockholder was to be computed upon the same mathematical formula as though the rights had been exercised, *i. e.*, in accordance with the principle that each original share having been acquired for \$710 and each additional share being obtainable for \$150, the cost of each share, whether original or additional, should, for the purposes of determining profit or loss, be deemed to be one-half (the additional stock was issued share for share) of \$860.

In *United States v. Mellon*, United States District Court, Western District of Pennsylvania (not yet officially reported but stated in Corporation Trust Company Income Tax Service, 1921, at page 586), a dividend was declared payable either in cash or in stock of the corporation at the option of the stockholders. It appeared, however, that the corporation contemplated that a great majority of the stockholders would accept stock and that in fact they did so. It further appeared that the defendant had made an agreement with the corporation whereby he was obligated to accept stock and the partnership of which he was a member was obligated to take up the stock which was not accepted by other stockholders in lieu of cash. The Court held that in substance the dividend constituted a stock dividend so far as the defendant was concerned and that he had received no income.

The significance of this rule, that regard must be had to substance and not to form, is that if we are right in our characterization of the transaction as a capital transaction resulting in nothing more than an alteration in the form of the

capital interest of the stockholder—that is the end of the whole case.

II. The meaning to be attached to the word “income” is not that ascribed to it by dictionaries or economists, but is, on the contrary, the meaning in which it is commonly used and understood.

In the *Macomber* case, Mr. Justice Pitney, speaking for the Court, said, at page 206:

“For the present purpose we require only a clear definition of the term ‘income’ as used in common speech in order to determine its meaning in the amendment.”

Mr. Justice Holmes in his dissenting opinion in the same case, which was concurred in by Mr. Justice Day, said at page 219:

“I think that the word ‘income’ in the Sixteenth Amendment should be read in ‘a sense most obvious to the common understanding at the time of its adoption,’ *Bishop v. State*, 149 Indiana 223, 230; *State v. Butler*, 70 Fla. 102-133. For it was for public adoption that it was proposed. *McCulloch v. Maryland*, 4 Wheat. 316, 407.”

In *Lynch v. Turrish*, 247 U. S. 221, Mr. Justice McKenna, for the Court, said, at page 224:

“The point in the case seems a short one. It, however, has provoked much discussion on not only the legal but the economic distinction between capital and income, and by what processes and at what point of time the former produces

or becomes the latter. And this in resolution of a statute which concerns the activities of men and intended, it might be supposed, to be without perplexities and readily solvable by the offhand conceptions of those to whom it was addressed."

In *Merchants Loan and Trust Company v. Smietanka*, 41 Sup. Ct. Rep. 386, 389, Mr. Justice Clarke, speaking for the Court, said:

"In determining the definition of the word 'income' thus arrived at, this Court has consistently refused to enter into the refinements of lexicographers or economists and has approved in the definitions quoted, what it believed to be the commonly understood meaning of the term, which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution."

It is a fact that although such a question as is presented in this case must be subjected to tests of greater refinement, nevertheless, the basic test, to which all other tests are merely supplementary, is whether, according to the common understanding of the man in the street, that which the taxpayer has received constitutes income. Can there be any doubt that in 1913 the man in the street would unhesitatingly have said that no income had been received by a stockholder in a corporation which, by reason of changed conditions, was under the practical necessity of transferring one of its business properties to a newly organized corporation, upon the condition

that the stock of the new corporation should be issued to the stockholders of the old one?

III. There are three essential elements of income: (a) gain, (b) separated from the capital and (c) realized by the recipient.

The established judicial expression of the common understanding of the word "income" is:

" 'Gain derived from capital, from labor, or from both combined,' provided that it be understood to include profit gained through a sale or conversion of capital assets." (*Eisner v. Macomber*, 252 U. S. 189, 207; *Goodrich v. Edwards*, 41 Sup. Ct. Rep. 390, 391.)

This definition was analyzed and explained by Mr. Justice Pitney in the *Macomber* case, at p. 207:

"Here we have the essential matter: *Not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived,' that is received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal;—that is income derived from property. Nothing else answers the description.*"

The statement of Mr. Justice Clarke in *Merchants Loan and Trust Company v. Smietanka* conveys the same thought:

"Notwithstanding the full argument heard in this case and in the series of cases now under consideration, we continue entirely satisfied with that definition, and, since the fund here taxed was the amount realized from the sale of the stock in 1917, less the capital investment as determined by the trustee as of March 1, 1913, it is palpable that it was a 'gain or profit' 'produced by' or 'derived from' that investment, and that it 'proceeded' and was 'severed' or rendered severable from it by the sale for cash and thereby became that 'realized gain' which has been repeatedly declared to be taxable income within the meaning of the constitutional amendment and the acts of Congress." (41 Sup. Ct. Rep. 389.)

Bearing in mind that these statements are designed simply to elucidate the commonly accepted meaning of the word "income," it would seem to be obvious that the transaction in question being in substance an exchange of one form of capital interest for another, nothing was separated from the capital and realized by the alleged recipient for the obvious reason that everything received was capital.

IV. In the case of a stockholder, income is not realized unless and until something has been freed from corporate control and business risks and transferred to the absolute ownership of the stockholder.

The relation of a stockholder to the corporation is such that there are many situations in which it might

be asserted that the stockholder has received the benefit of the earnings of the corporation in such a way as to make it proper that he should be treated as having received income. It became necessary, therefore, for this Court to lay down some definite rule which should work out a fair result to the stockholder and at the same time comply with the spirit of the tax statute. That rule is that income is not realized unless and until something has been freed from corporate control and business risks and transferred to the absolute ownership of the stockholder.

The two cases which best illustrate the application of the test to determine whether a stockholder has received income are *Lynch v. Hornby*, 247 U. S. 339 and *Eisner v. Macomber*, 252 U. S. 189.

In the *Hornby* case it was held that dividends distributing earnings accumulated before March 1, 1913, which admittedly constituted capital of the corporation on that date, were taxable against the stockholder for the year in which received, although it was appreciated that to the extent that the stockholders were enriched by the dividend the corporate assets were diminished and, theoretically at least, the value of the stock reduced. Two lines of thought underlie the decision: (1) In common understanding, a dividend is a recurrent thing, equivalent to interest or rent and is income to the stockholder, even though an economist might say that it is not; (2) something of value has been transferred from the ownership of the corporate entity to the ownership of the individual stockholder.

In the *Macomber* case this Court held that the word "income," "as used in common speech" did not include a stock dividend and it was stated very forcibly that thereby nothing has been separated from the corporate assets and the risks of the business and transferred to the absolute ownership of the stockholder for his own use and benefit.

The test therefore is to find (1) the common sense of the thing, and (2) whether anything has been separated from the capital investment so that instead of remaining corporate property subject to business risks, it becomes the absolute property of the individual stockholder.

The principle which underlies the test is that everything which remains corporate property remains a part of the property with respect to which the stockholder has a capital interest, so that it would be a contradiction in terms to say that something which is corporate property constitutes income to the stockholder. The practical consideration which underlies the test is that so long as something remains corporate property it remains beyond the reach of the stockholder to deal with as his own, and since he is powerless to remove it from corporate control it may at any time be lost in the business.

In the case at bar both this principle and this practical consideration compel the conclusion that the stockholders of the oil companies received no income. Everything which had been corporate property remained

corporate property, and nothing was transferred from corporate control to the individual ownership of the stockholder.

V. The Towne case illustrates the application of the foregoing rules and principles to facts very similar to the facts in the case at bar and is conclusive that the stock of the pipe line companies did not constitute income within the meaning of the Income Tax Law of 1913.

In *Towne v. Eisner*, 245 U. S. 418, the question was whether a true stock dividend was taxable at its par value under the Income Tax Law of 1913. The stockholder maintained that the stock received by him did not constitute income within the meaning of the statute and, further, that if the statute were construed so as to impose a tax thereon it was unconstitutional and void. This Court unanimously held that the dividend did not constitute income within the meaning of the Income Tax Law of 1913.

The Government argued that the additional shares of stock received by the stockholder were things of value received by reason of his stock ownership and the existence of a surplus and that they constituted income. The Government also argued that the transfer from surplus to capital account constituted a distribution of surplus to the stockholders.

These arguments, which are precisely the same as the arguments made in the case at bar, were summarily rejected by this Court which said that since the sub-

stance of the thing was that nothing had been taken from the corporate property and added to the interest of the stockholder and that the only change was in the form of the stockholder's capital interest, it was clear that Congress had not intended to impose a tax upon the shares received as a stock dividend.

The first point made by the Court was that a stock dividend does not constitute income as between life tenant and remainderman under *Gibbons v. Mahon*, 136 U. S. 549, and other decisions of this Court. Can any one imagine that it would seriously be contended in a jurisdiction adopting the rule of this Court as to the allocation of stock dividends between life tenant and remainderman that the issue or distribution of the stock of the pipe line companies constituted income to the life tenant? It would be a litigious life tenant who would bring such a case to court and assert it to be distinguishable in his favor from the case of a true stock dividend. We think that such a court would listen impatiently to the argument of the life tenant that he is entitled to the stock of the pipe line companies because it is the stock of a new corporation instead of the stock of the old one, and that it would promptly say that it belongs to the remainderman because it evidences that earnings have not been distributed but have, on the contrary, been capitalized and irrevocably committed to corporate purposes and business risks.

In *Wilberding v. Miller*, 90 Ohio St. 28, 106 N. E. 665, the question concerned the respective rights of life

tenant and remainderman in 500 shares of stock of the Latrobe Steel Company which had been received by trustees when the Latrobe Steel Works, of which the trustees had held 250 shares, sold all of its assets, a large part of which represented surplus, for stock of the Latrobe Steel Company. The Court referred particularly to *Gibbons v. Mahon*, *supra*, and held that all of the stock belonged to the remainderman.

See, also:

Bulkley v. Worthington Ecclesiastical Society,
78 Conn. 526, 63 Atl. 351,
Goldsmith v. Swift, 25 Hun (N. Y.) 201,
Mercer v. Buchanan, 132 Fed. 501, 137 Fed.
1019.

The second point made by the Court in the *Towne* case was that after the payment of the dividend the stockholder was no richer than before. It is admitted that the same thing is true in the present case.

Finally, the Court said that the substance of what happened was that the stockholder's old certificates had been split up and had diminished in value to the extent of the value of the new. This is precisely what happened in the case at bar.

We submit that the *Towne* case is conclusive of the question raised in the case at bar and that the opinion in that case expresses clearly and emphatically in a few words precisely the ideas which we have attempted to present. The idea that the receipt by a stockholder of additional shares of stock in a corporation which retains,

or of new shares of stock in a corporation which acquires, and capitalizes corporate assets in which the stockholder formerly had a stockholder's interest and which merely preserves the proportionate capital interest of the stockholder from impairment, is a capital transaction amounting only to an alteration in the form of the stockholder's interest and does not result in the receipt of income, cannot be more clearly expressed than in the words of Mr. Justice Holmes:

“What has happened is that the plaintiff's old certificates have been split up in effect and have diminished in value to the extent of the value of the new.” (245 U. S. 427.)

The Government boldly asserts that a tax statute, which must be construed most favorably to the taxpayer, under which the taxpayer is entitled to the benefit of every doubt and which has already been authoritatively construed not to include stock issued by a corporation against surplus transferred to capital account, shall be construed so as to impose a tax upon the market value of stock issued against business plant, which, as a practical business necessity, was transferred to a newly organized corporation upon the condition that the stock of the new corporation should be issued to the stockholders of the old.

We think that, if anything, the distinction should be the other way. The Government assumes that the decision in the *Towne* case must be *extended* in order to cover the case at bar. We submit that this assumption

is totally unwarranted and that in fact the case at bar is an even clearer case than the case of a true stock dividend.

The fundamental basis of the *Towne* decision is that the issue of a stock dividend is nothing more than a capital transaction which results in an alteration in the form of the stockholder's interest. A stockholder has say 100 shares of stock (which is one-tenth of the total issue), of a corporation which has a capital stock of \$100,000 and a book surplus of \$100,000. The corporation transfers that surplus to capital account and declares a stock dividend of 100%. As a result of the dividend the stockholder receives 100 additional shares. Those shares represent a one-twentieth interest in a corporation which has a capital of \$200,000 and no surplus. The original shares now represent a one-twentieth interest in that corporation. Formerly they represented a one-tenth interest in a corporation which had a capital of \$100,000 and a 100% surplus. The decision holds that what has happened is that the original 100 shares have been exchanged for 200 new shares, which represent the same proportionate interest in the corporation that the 100 shares formerly represented. The 100 original shares are "new" shares because they now represent something different from what they did before, but the 200 shares represent, in the hands of the stockholder, nothing more than he had before. Clear as this is in the case of a true stock dividend, we believe that

it is even clearer in the case of the transaction had in the case at bar.

Furthermore, a true stock dividend is dependent upon the existence of surplus and bears a direct relation to the amount thereof; whereas in the case at bar the existence of surplus was purely incidental and, as is pointed out at page 25 of this brief, the tax which the Government claims bears no relation to the amount by which surplus was reduced. On the contrary the Government claims a tax upon an amount which, taking the stock of the two pipe line companies collectively, is more than twice as great as the amount by which surplus was reduced.

Another factor which exists in the case of a stock dividend and does not exist in the case at bar, is that the issue of stock dividends might be made recurrent, whereas, it is not probable that such a transaction as is involved in the case at bar could happen more than once in the life of a corporation. Certainly it could not be used as a means to give to stockholders from time to time the practical benefit of corporate profits. Finally, while a stock dividend is ordinarily declared in the discretion of the board of directors, the business readjustment consummated in the case at bar was, practically speaking, compulsory.

The directors of the old companies were as much under legal compulsion to do what they did as if a court decree had ordered the transfer of the pipe line properties to new corporations and the apportion-

ment of the stock of the new corporations to the stockholders of the old. The law requires directors to conduct the business of the corporation efficiently. The efficient conduct of the business of these corporations prevented the continuation of the conditions which prevailed at the end of 1914 and necessitated the transfer of the pipe line properties. The directors appreciated that the pipe line properties had a potential value which could not be realized by a sale to outside interests at that time. The Prairie Oil & Gas Company was expressly prohibited by statute from holding the stock of The Prairie Pipe Line Company. The Ohio Oil Company could hold the stock of The Illinois Pipe Line Company only at the constant risk of objection by State and Federal Commissions. Such being the situation, the directors did what the law required to be done, and did it in the only way that it could be done—they submitted to the stockholders a plan whereby the transfer of the pipe line properties might be effected and at the same time the potential and future value thereof might be retained for the benefit of the stockholders. That was the plan which the stockholders accepted and which was carried out. Nothing could be clearer than that there was no determination that surplus should be distributed to the stockholders. The entire purpose and intent of the proceeding was that all of the assets should be retained in the enterprise and that the relation of the stockholders thereto should, so far as possible, remain unchanged.

The soundness of the decision in *Towne v. Eisner* has

never been questioned. On the contrary, it was expressly approved by the majority of this Court and by Mr. Justice Holmes and Mr. Justice Day in the *Macomber* case. Mr. Justice Pitney there said on behalf of the Court, p. 201:

“We are constrained to hold that the judgment of the District Court must be affirmed. First, because the question at issue is controlled by *Towne v. Eisner*, *supra*; secondly, because a re-examination of the question, with the additional light thrown upon it by elaborate arguments, has confirmed the view that the underlying ground of that decision is sound, that it disposes of the question here presented, and that other fundamental considerations lead to the same result.”

He further said, at p. 205:

* * * “We adhere to the view then expressed, and might rest the present case there; not because that case in terms decided the constitutional question, for it did not; but because the conclusion there reached as to the essential nature of a stock dividend necessarily prevents its being regarded as income in any true sense.

“Nevertheless, in view of the importance of the matter and the fact that Congress in the Revenue Act of 1916 declared (39 Stat. 757) that a ‘stock dividend shall be considered income, to the amount of its cash value,’ we will deal at length with the constitutional question, incidentally testing the soundness of our previous conclusion.”

In the dissenting opinion of Mr. Justice Holmes, in which Mr. Justice Day concurred, it is stated, at page 219:

"I think that *Towne v. Eisner*, 245 U. S. 418, was right in its reasoning and result and that on sound principles the stock dividend was not income."

Mr. Justice Brandeis in his dissenting opinion in the *Macomber* case says that the *Towne* case simply involved a question of statutory construction and that it was there indicated that a different decision might be reached in construing the Amendment. It is clear that he deemed nothing which he said in that opinion in any way inconsistent with what was held and said in the *Towne* case.

In construing the Act of 1913, every presumption favors the taxpayer and if there be any doubt that in using the words "income derived from dividends" Congress intended to impose a tax upon the stockholders of a corporation which has made such a business readjustment as was made in the present case, that doubt must be resolved against the Government and in favor of the taxpayer, and it must be held that no tax has been imposed.

VI. The opinion of the Court in the *Macomber* case is simply a more thorough analysis of the facts and principles which controlled the decision in the *Towne* case, and an extension of that decision to cover the construction of the Sixteenth Amendment.

The opinion of the Court in the *Eisner v. Macomber*,

252 U. S. 189, case lays down no new rules or principles for the determination of the question of the taxability of a stockholder, but simply applies the principles which had been laid down in other cases and particularly in the *Towne* case, and, in applying them, analyzes with minuteness the nature of a stock dividend from the point of view of the stockholder

The question was whether a true stock dividend constituted income within the meaning of the Sixteenth Amendment. The case arose under the Revenue Act of 1916, which by its express terms provided that a stock dividend should be taxed as income. The dividend involved was a fifty per cent. stock dividend of the Standard Oil Company of California issued in January, 1916, against a transfer from surplus to capital account. The plaintiff had been taxed upon the par value of the additional shares received and brought suit to recover the amount paid.

The Court first referred to the decision in the *Towne* case and said that "the question at issue is controlled by" it, and that a re-examination of the question "has confirmed the view that the underlying ground of that decision is sound, that it disposes of the question here presented, and that other fundamental considerations lead to the same result." It further said that the conclusion there reached "as to the essential nature of a stock dividend necessarily prevents its being regarded as income in any true sense."

Nevertheless, the Court proceeded to "deal at length

with the constitutional question, incidentally testing the soundness" of its previous conclusion. It referred to the case of *Pollock v. Farmers' Loan & Trust Company*, 158 U. S. 601, and the particular phraseology of the Sixteenth Amendment, and said that in view of that decision and the language of the Amendment it became essential to distinguish between what is and what is not income and to apply the distinction as cases arise "according to truth and substance, without regard to form." It then stated that, having once adopted a clear definition of the term "income" as used in common speech, and having formed a correct judgment as to the nature of a stock dividend, it will be "easy to decide the matter at issue."

The definition adopted was that which we have already stated, and it was elucidated by Mr. Justice Pitney in the words quoted at page 34 of this brief.

The Court then proceeded to discuss the nature of a corporation and the stockholder's relation to it, and stated that the interest of the stockholder is a capital interest as regards surplus as well as capital, and that his certificates of stock are but the evidence of that interest. The rights of the stockholder were summarized to be (1) the right to have the property devoted to the attainment of the common objects; (2) the right to vote at stockholders' meetings; (3) the right to receive dividends out of profits if and when declared; and (4) the right to receive a proportionate share of the assets in the event of liquidation. It was clearly pointed out that short of liquidation, or until a dividend is declared, the stock-

holder has no right to withdraw any part of either capital or profits, and that he can dissociate himself from the company and remove his capital from the risks of the enterprise only by disposing of his stock.

The Court observed that a dividend "normally is payable in money, under exceptional circumstances in some other divisible property; and when so paid, then only (excluding, of course, a possible advantageous sale of his stock or winding-up of the company) does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital which he or his predecessor has invested."

The Court next described how, in a growing business, only a part of the year's profits are ordinarily capable of division and how the remainder, being absorbed in the acquisition of increased plant or equipment goes to increase the undivided profits or surplus of the corporation, which, in the nature of things, is not capable of distribution to and division among the stockholders. The Court then explained that the surplus "may be adjusted upon the books by the declaration of a stock dividend, but this is no more than a book adjustment, in essence not a dividend, but rather the opposite." The Court then said at p. 211:

"A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being

a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution."

At page 211, the Court summed up the whole matter in a single paragraph:

"The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations, have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

The Court then went on to point out that if after the issue of a stock dividend a stockholder should sell a part of his stock, he would as truly diminish his proportionate proprietary interest below what it was originally, as if he had sold a part of his stock before the issue of the stock dividend, and to say that, admittedly, if the stockholder should sell stock at a profit he would be taxable upon any profit realized, and then said (p. 213):

“Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax.”

The Court next proceeded to dispose of the argument that the corporate entity might be disregarded, and it did so by saying that it would not be consistent to regard the distinction between the corporate entity and the body of stockholders for the purposes of imposing a tax when profits are transferred from the ownership of the corporate entity to the ownership of the stockholding group, and, at the same time, to say that when profits are transferred to the capital account of the corporate entity the distinction should be abandoned and the ownership by the corporate entity treated as the equivalent of ownership by the stockholding group.

The Court rejected the argument that the new certificates measure the extent to which the gains accumulated by the corporation have enriched the stockholder, because, in the first place, the accuracy of the measurement would depend upon how long the stockholder had held the stock, and, secondly, because “enrichment through increase in value of the capital investment is not income in any proper meaning of the term.”

Finally, the Court took up the argument that the

Act of 1916 might be construed so as to impose the tax not upon the stock dividend, but rather upon the stockholder's share of the undivided profits previously accumulated by the corporation. The Court rejected this argument, saying that such a tax would be unconstitutional as a direct tax not authorized by the Sixteenth Amendment, which applies to income only, since "what is called the stockholder's share in the accumulated profits of the company is capital, not income," for the reason that "a stockholder has no individual share in accumulated profits nor in any particular part of the assets of the corporation, prior to dividend declared."

VII. The Macomber case is conclusive that the stock of the pipe line companies did not constitute income within the meaning of the Sixteenth Amendment.

The conclusion at which this Court arrived in the *Macomber* case, after an exact analysis of the nature of a stock dividend, was that the transaction whereby a stockholder, who formerly held, say 1/1,000 of the outstanding shares of a corporation which had a 100% surplus, receives additional shares of stock issued against the transfer of the surplus to capital account and still has 1/1,000 of the outstanding shares of the corporation, which now has no surplus, but the capital of which is equivalent to the former surplus and capital combined—is a capital transaction amounting to nothing more than a change in the form of the stockholder's capital interest, and does not constitute the receipt of income.

It is not necessary that we should demonstrate that the transaction consummated in the case at bar is the precise equivalent of the issue of a stock dividend. It is sufficient to show that in substance its nature and effect are the same. Unless an analysis of the transaction involved in the case at bar shows that it is substantially different in nature from the issue of a stock dividend, the *Macomber* case is conclusive upon every question raised here, and constitutes the acceptance by this Court of our conception of the fundamental nature of the transaction.

In the *Macomber* case the Court made five distinct points in reaching its conclusion that a stock dividend does not constitute income:

- (1) The effect of a stock dividend is to capitalize, rather than to distribute, corporate earnings.

- (2) The declaration of a stock dividend transfers nothing from the corporate assets and risks of the business to the individual use and ownership of the stockholder.

- (3) The stockholder who has received a stock dividend cannot pay a tax thereon without disposing of a part of his capital investment.

- (4) The corporate entity cannot be disregarded for purposes of saying that the transfer from surplus to capital was the equivalent of a transfer to the stockholders.

- (5) The new stock issued as a stock dividend

does not measure the extent to which the earnings accumulated by the corporation have enriched the stockholder.

Let us take up each of these points *seriatim* and see whether the difference which admittedly exists in the case at bar that the transfer was to a separate corporation, has any materiality under any of them.

(1) The distinction between the surplus and the capital of a corporation is that the surplus may be distributed at any time, in the discretion of the board of directors, while the capital may not be so distributed. It was that distinction which this Court was making when it said that the effect of a stock dividend is to capitalize, rather than to distribute, corporate earnings. Of course, the truth of the matter is that the transfer of the pipe line properties to the pipe line companies did not effect a transfer of surplus at all, but was simply a transfer of capital assets, constituting a distinct business plant, from one corporation to another, which necessarily reduced the surplus of the transferrer corporation. But assuming, for the purposes of argument, that the transfer of the pipe line properties did constitute a transfer of surplus, the transfer was to capital account of the pipe line companies, and was as much a capitalization as if it had been carried to the capital account of the oil companies.

(2) The distinction which this Court had in mind, when it said that the declaration of a stock dividend transfers nothing from the corporate assets and the risks

of the business to the individual use and ownership of the stockholder, has been brought out at pages 37 and 49 of this brief. The conception on the one hand is of corporate assets which are beyond the reach of the stockholder, and which may be lost in the business at any time; and, on the other hand, the conception of property which the stockholder receives to do with as he pleases, free from any restraint by directors or majority stockholders. Into which category fall the pipe line properties which became the corporate assets of the pipe line companies?

Does the commonly accepted understanding of the word "income" turn upon a distinction so fine as that which differentiates between corporate control and the risk to corporate assets when assets remain the property of an original corporation carrying on two classes of business, and when they become the property of two corporations each organized to carry on one of those businesses separately?

(3) It is admitted that if a stockholder sells any of the stock of the oil companies or of the pipe line companies he is reducing the proportion of his interest just as much as if he sells some of the stock issued to him as a stock dividend. Without selling he has not the wherewithal to pay the tax which the Government demands. If he sells he does more than part with property. He reduces his proportionate interest in the corporate enterprise and can no longer enjoy the full benefit of the interest which he acquired.

When stock of the oil companies or of the pipe line companies is sold under such circumstances that the stockholder has realized a profit, that profit should be taxable in the manner described and under the Treasury Department Regulations referred to at page 27 of this brief, but until then the stockholder has received no income.

(4) The reason that the corporate entity cannot be disregarded for purposes of saying that the transfer from surplus to capital is the equivalent of a transfer to the stockholders, is that it is only by recognizing the corporate entity that "any dividend—even one paid in money or property—can be regarded as income of the stockholders." In the case at bar the same reason prevents the transfer to the pipe line companies from being treated as the equivalent of a transfer to the stockholders. The Government invokes the existence of the corporate entity to say that the stockholders of the oil companies received a dividend, but it attempts to discard it for the purpose of saying that the transfer to the pipe line companies was a transfer to the stockholders. This Court has said that the Government will not be allowed to indulge in such inconsistencies.

To put it in another way: If the corporate entity of the pipe line companies may be disregarded for purposes of saying that the pipe line properties were distributed to the stockholders of the oil companies, then to be consistent the Government must admit that before the transfer the stockholders of the oil companies were the owners

of the pipe line properties. The Government cannot blow both hot and cold. It must treat all corporate entities alike. It may not regard some and disregard others.

The corporate entity is not a thing which may be lightly regarded or easily disregarded. It is sometimes called a fiction, but it is in fact a thing of substance. It is true that there are certain circumstances under which it may be disregarded. Those circumstances are, however, limited to cases in which the corporate entity is sought to be availed of as a cover for fraud, or to effect the accomplishment in substance of what it is desired to avoid the accomplishment in form. In the case at bar there was, of course, no fraud, and it is clear that the last thing which the directors of the oil companies wished to accomplish was a physical distribution of the pipe line properties to the stockholders.

(5) If it is true that additional stock issued as a stock dividend does not measure the extent to which the earnings accumulated by the corporation have enriched the stockholder, it is too plain for argument that the stock of the pipe line companies does not measure the extent to which a stockholder in the oil companies has been enriched by the accumulation of earnings. In both cases the point is that the stockholders of a corporation do not all acquire their interests simultaneously, but, on the contrary, purchase stock at many different times and under many varying conditions of the prosperity of the corporation, the amount of its surplus and the price of its shares.

The Government argues that what this Court said in the *Macomber* case does not apply in the case at bar for two reasons: first, because the stock of the pipe line companies became a part of the assets of the oil companies; and, second, because the transfer of the surplus of the oil companies, which it assumes took place when the pipe line properties were transferred, was a transfer to a new, separate and independent corporation.

Under Point Three (page 68) we shall answer the assertion of the Government that the stock of the pipe line companies became a part of the assets of the oil companies. But, assuming for purposes of argument that it did, that furnishes no basis for distinguishing what was said in the *Macomber* case. "Regard must be had to the substance" of the transaction. Once it is established that the substance of the transaction is that it was a capital transaction involving merely an alteration in the form of the stockholder's interest, then no purely technical formality with respect to the method of the distribution of the stock of the pipe line companies, or either of them, will be allowed to prevent the disposition of the case on the merits and in accordance with sound principles and the precedents established by this Court. The argument of the Government that it is of importance that the stock of the pipe line companies became actually or constructively part of the assets of the oil companies does not go to the merits of the question, but can be availed of for no other purpose than to make the technical point that the alleged existence of that fact in the case at bar, and not

in the stock dividend cases, is a reason why the true nature and substance of the transaction involved in the case at bar should not be regarded as was the substance of the transaction involved in the stock dividend cases. The statement of that argument is its own refutation.

To put it in another way: A regard for the substance rather than the form of the transaction necessitates that, even if it be assumed that the stock of the pipe line companies became a part of the assets of the oil companies, nevertheless, the inquiry must be made whether, viewing the transaction in its entirety, that stock constitutes income. The Government cannot narrow the point of view from which the transaction is examined so that it may be seen as simply the distribution by a corporation to its stockholders of shares of stock of another corporation with a resultant reduction in surplus. The transaction whereby the pipe line properties were transferred so that they ceased to be assets of the oil companies and became the property of the pipe line companies, and whereby the pipe line companies issued stock to, or for distribution to, the stockholders of the oil companies, was a single entire transaction.

Even if it were possible for the Government to succeed in sustaining its theory that the stock of the pipe line companies became a part of the assets of the oil companies, it would have proved only a part of its case, for it is then that the real inquiry arises: Did this stock constitute income? That can be answered only by an examination of the entire transaction. We must begin at

the beginning, not in the middle, and doing so, we find corporations with generous surpluses which might have been distributed to the stockholders in the form of dividends. The question is: Were those profits so distributed? The answer is that they were not; that far from it, they were put beyond the power of distribution, taken from the oil companies which might have distributed them, and segregated as the undistributable capital of the pipe line companies.

We wish to repeat once more what we have so often said, that the receipt by the stockholders of the oil companies of the stock of the pipe line companies was the receipt of nothing more than was necessary to preserve to them the proportionate interest which they had originally held in an enterprise consisting of both an oil manufacturing business and a pipe line business; and that to say that the mere preservation of that capital interest could result in the receipt of income, is to lose sight of every distinction essential to a proper determination of the question involved.

The Government's second ground of distinction, namely, that the assumed transfer of surplus was to a new corporation, ignores the spirit of everything which this Court said in the *Macomber* case. Since the real basis of the decision in the *Macomber* case was that a stock dividend is purely a capital transaction, the fundamental question in the case at bar is whether the issue or distribution of the stock of the pipe line companies was a capital transaction. Therefore, the difference that

the transfer was to a different corporation can render what was said in the *Macomber* case inapplicable, only if it demonstrates, or tends to demonstrate, that the transaction was not a capital transaction. As we have already stated, the transfer of a distinct business from one corporation to another is even more clearly a capital transaction, from the point of view of the stockholder, than is a transfer of a book surplus from surplus account to capital account. Therefore, the Government fails utterly in its attempted distinction.

We think that the Government's argument on this point is expressed as forcibly as it can be expressed in the opinion of the learned Court below. In that opinion the separateness and independence of the oil companies and the pipe line companies are pointed out and it is stated that the pipe line properties were irrevocably and absolutely transferred from the oil companies to the pipe line companies. The opinion proceeds:

"In *Eisner v. Macomber*, 252 U. S. 189, the case was of a mere stock dividend, which was held to be no more than new evidence of the stockholder's original ownership. Had the shares been without par value, that would have been literally the case, but they were not. The stock dividend did change the relation of the corporation and the stockholder to the surplus, by permanently impounding it, as it were, in the business, and giving the stockholder a right to insist upon it as an investment, should his fellows later wish to realize it as profit. Yet, though he thus got, and the cor-

poration lost, this element of control over the surplus so declared, it was not regarded as a severance of the property. So far, therefore, *Eisner v. Macomber, supra*, helps the taxpayer here; it shows that there may be some changes in the relation of the stockholders to the surplus which do not amount to the severance of income.

Nevertheless, the cases at bar go further than that case because in them the surplus was transferred to a new corporation altogether, and the question is whether that distinction changes the result. The taxpayers insist that if one looks at the very truth of the matter, disregarding corporate forms, this is no difference at all. Although the argument is plausible, it still seems to me, that, even when viewed with the completest disregard of forms, the pipe line properties were completely severed from the oil companies and that the resulting shares were new property derived from the old shares."

With due respect to the learned Court below we submit that the last sentence quoted above reveals the error in its reasoning. That error consists in assuming that the separation of the pipe line properties from the oil companies to the pipe line companies was a separation to the stockholders of the oil companies for their separate use and benefit. We think that the Court below would have avoided this error if it had looked at the question from the point of view of the individual stockholder rather than from the point of view of the body of stockholders collectively. When the trans-

action is looked at from the point of view of the whole body of stockholders, it is comparatively easy to fall into the error of assuming that a transfer to the corporation is equivalent to a transfer to the body of stockholders collectively. But when the transaction is regarded from the point of view of Smith, the owner of a hundred shares of each of the oil companies, it becomes apparent at once that when the pipe line properties were transferred to the pipe line companies Smith received no part of those properties, but, on the contrary, merely retained his stockholder's interest in them.

It is true that ordinarily, if there has been a separation from the assets of the corporation, the separation is to the stockholder and he receives the use and benefit of that which has been separated. However, in the particular circumstances presented in the case at bar this was not so, and the separation instead of being made to the stockholders was made to another corporation. Thereafter, as before, a corporate entity intervened between the stockholder and the property. The property was neither his in legal contemplation nor as a practical matter. He could not deal with it as his own. He could not sell it or use it or put it away for safe keeping. He could only exercise his proportionate voice in the control of it, await such dividends as he might receive out of its earnings, and have faith that it would not be lost in the business enterprise. The practical difference is not only that the stockholder does not receive the absolute possession and ownership and the full use and benefit of that

which has been transferred, but also that it remains a part of his capital investment. Clearly such a separation can not come within the intendment of the rule.

The Court below says that the shares of stock of the pipe line companies "were new property derived from the old shares." It may be true that they were new property. But they were not "new property derived from the old shares" within the meaning which is conveyed when it is said that "income is derived from capital." The meaning in that connection is that something new is derived without impairment of the old capital—something is received in addition to the capital and not in substitution for it. Fruit is the income derived from a tree. It is an addition to the tree and may be separated from it without constituting an impairment. If the trunk of a tree be split by lightning, and the two parts continue to grow and bear fruit, neither of those parts constitutes income, because neither is an addition to, and both are in substitution for, the original single tree.

If I divide my apple in halves, it is correct to say either that I have an apple divided in halves or that I have two half apples, depending upon whether what I now have be viewed as the original entire apple divided in two parts or as two new half apples created by the division. But certainly it cannot be said that one of the halves is a new half apple and the other is the original complete piece of fruit. Yet this is precisely what the Court below says when it states that the shares of stock of the pipe line companies "were new property derived from the old shares."

When the learned Court below illustrates its point by assuming for purposes of illustration that the pipe line properties had been conveyed to the stockholders as co-owners and that they had incorporated for convenience, and then states that judged by results this is exactly what happened, and that if that had happened the original conveyance would have been taxable, we submit that the Court fell into error. In the first place, we believe that if the pipe line properties had been conveyed in specie to the stockholders as co-owners it would have constituted a partial liquidation and therefore not have been taxable as a dividend. In the second place, the two things which the learned Court below treats as equivalents are in fact diametrical opposites. If the pipe line properties had been transferred to the stockholders they would have had the absolute possession and ownership thereof for their own use and benefit, which is precisely what they did not have when the pipe line properties were conveyed to the pipe line companies, and the stockholders received only a derivative interest therein.

The argument of the Court below is precisely the argument which was made in the *Macomber* case, that there is no difference between a simple stock dividend and a case where stockholders use money received as cash dividends to purchase additional stock contemporaneously issued by the corporation. In answering this argument this Court said, at page 215:

“But an actual cash dividend, with a real

option to the stockholder either to keep the money for his own or to reinvest it in new shares, would be as far removed as possible from a true stock dividend, such as the one we have under consideration, where nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subjected to their disposal."

The Court below suggests that "no one would urge that the new shares were not altogether income" if the pipe line companies had been going concerns with property of their own. The whole point in the case at bar is that after the transaction the stockholder had a stockholder's interest in precisely the same business in which he had a stockholder's interest before the transaction. The case which the Court below puts is one in which after the transaction the stockholder has an interest in a new and different business. It will not do to use this case as an analogy when it differs in the precise feature which constitutes the point in issue.

To come back to what is the crux of the case, we find that we have been dealing with technicalities and metaphysical distinctions which have no place in a proper consideration of the question at issue.

The real answer to every argument which the Government can make in this case is that any theory that the transfer of the pipe line properties constituted a transfer of the surplus of the oil companies, and that that transfer was a transfer to the stockholders of the oil companies is nothing more nor less than a metaphysical perversion of the entire transac-

tion, of which the true substance was that nothing happened except that the form of the stockholder's capital interest was changed, so that instead of being represented by the stock of a single corporation it was represented by the stock of two corporations.

VIII. Any dissent in the *Macomber* case was based upon considerations which have no application in the case at bar.

In the dissenting opinion in the *Macomber* case written by Mr. Justice Holmes and concurred in by Mr. Justice Day, it is said that the word "incomes" in the Sixteenth Amendment should be read "in a sense most obvious to the common understanding at the time of its adoption" and that "most people not lawyers would suppose when they voted for it that they put a question like the present to rest." We believe that it is clear that the dissent of Mr. Justice Holmes and Mr. Justice Day was due to a difference of opinion as to whether in 1913 the man in the street would have considered a stock dividend to be income. We believe that, for reasons frequently reiterated in this brief and stated particularly at page 43, there can be no such difference of opinion as to whether the man in the street would have considered the stock of the pipe line companies to be income. We submit, with all confidence, that "most people not lawyers" would have had no hesitation in saying that the stock of the pipe line companies was not income.

Two fundamental lines of thought seem to underlie the dissenting opinion of Mr. Justice Brandeis in which

Mr. Justice Clarke concurred. First, they felt that the issue of a stock dividend was the equivalent of the alternative method of declaring a dividend in cash and giving the stockholder a right to subscribe to new stock; and, second, they considered that, even if in the past stock dividends had not been issued for the express purpose of in effect distributing the corporate earnings, at least in the future they would be issued for that purpose. Neither of these lines of thought reaches the transaction had in the case at bar. The particular form of the transaction was one for which there was no alternative. The transaction was not inspired by any desire to distribute to the stockholders a part of the accumulated profits or the equivalent thereof. It was, on the contrary, a business readjustment which circumstances rendered practically compulsory. Finally, the transaction was not one which could as a practical matter be repeated for the purpose of providing the stockholders with the equivalent of cash.

POINT THREE.

The stock of the pipe line companies did not become a part of the assets of the oil companies.

The only point argued by the Government in the Court below was that the stock of the pipe line companies became a part of the assets of the oil companies so that under the rule of *Peabody v. Eisner*, 247 U. S. 347,

a distribution thereof constituted a distribution in the form of a dividend, of a part of the surplus of those companies. This argument was rejected by the learned Court below, which said:

“Neither the Prairie Gas & Oil Company nor the Ohio Oil Company for any moment of time owned the pipe line shares as free assets. This is very clear in the case of the Prairie Company, the transaction in which,—observing now the most scrupulous formality,—was this. The pipe line company offered to buy the oil company’s pipe line assets for \$27,000,000,—adjusted to actual values,—and to give in payment its own shares to be directly distributed by the pipe line company *pro rata* among the oil company’s stockholders. This offer the oil company accepted and the contract of January 21, 1915, bound the buyer so to distribute the stock, which it did. This was a contract made for the sole benefit of the oil company’s stockholders and could probably have been directly enforced by them at law, *Hendrick v. Lindsay*, 93 U. S. 143, *National Bank v. Grand Lodge*, 98 U. S. 123, 124, (semble). Yet it was the only contract by which the oil company ever got any conceivable interest in the pipe line shares, and it gave that company no such interest. It had given away its property for a consideration moving directly to third persons.

In the case of the Ohio Company, formally the contract bound the pipe line company to deliver its shares to the oil company and they thus would have become free assets, if there had been nothing more. However, in the very reso-

lution of the oil company's board of directors by which the offer of the pipe line company was accepted the board declared a *pro rata* distribution of the pipe line shares among its own stockholders. Thus at the moment of concluding the contract by which alone the oil company got any interest in the shares, the property so acquired was declared as a dividend. That declaration gave the stockholders of the oil company an immediate vested right to the dividend so declared. *Staats v. Biograph Co.*, 236 Fed. R. 454, (C. C. A. 2nd) *Hopper v. Sage*, 112 N. Y. 530, *Raynolds v. Diamond Mills Paper Co.*, 69 N. J. Eq. 299, 300."

We need add nothing to this statement.

POINT FOUR.

There is a fundamental distinction between the distribution to stockholders of liquid treasury assets on the one hand, and, on the other hand, the proceeds of the disposition of business plant constituting an integral part of the enterprise.

The Government repeatedly refers to *Peabody v. Eisner*, 247 U. S. 347, as though it had some bearing on the question involved in the case at bar. We submit that the decision in that case is entirely irrelevant. In the *Peabody* case the plaintiff was a stockholder of the Union Pacific Railroad Company, which on and prior to March 1, 1913, had purchased out of earnings a considerable

amount of the common and preferred stock of the Baltimore & Ohio Railroad Company and had the same lying in its treasury. On March 2, 1914, the Union Pacific declared and paid an extra dividend upon each share of its common stock, amounting to \$3 in cash, \$12 in preferred stock of the Baltimore & Ohio at par, and \$22.50 in common stock of the Baltimore & Ohio at par. The entire amount of the dividend was held taxable.

The only real question presented in the case was precisely the same question which was presented in the *Hornby* case, namely, whether the fact that a dividend was paid out of surplus existing on March 1, 1913, prevented it from constituting taxable income. It could not have been, and in fact it was not, even suggested in the *Peabody* case that the dividend paid by the Union Pacific was any the less income because the medium of payment was liquid property rather than cash.

The distribution of the Baltimore & Ohio stock was part of a recurrent dividend and had all the characteristics of a taxable dividend. In the hands of the Union Pacific the Baltimore & Ohio stock had been merely a liquid investment of surplus. The intention in distributing it was to give, and there was given, to the stockholder property of value for his own separate use and benefit freed from any further relation to the Union Pacific enterprise. The sale by a stockholder of a part or all of the Baltimore & Ohio stock received would not have diminished his proportionate interest in the enterprise in which he was a stockholder.

In the case at bar no liquid investment and no mere treasury assets were distributed. There was no intention of giving anything to the stockholder for his separate use and benefit, and nothing was so given to him. The transaction, whether viewed from the standpoint of the corporation or from that of the individual stockholder, was not intended to and did not result in giving the stockholder anything separated from the enterprise, but, on the contrary, the entire object of the transaction was to retain all of the business properties subject to corporate control and at the same time to preserve to the stockholder his proportionate stockholder's interest in the enterprise. When the stockholders of the oil companies authorized the transaction they did so on the understanding and condition that none of the business properties should be distributed to them, but that, on the contrary, all should remain subject to corporate control. The sale by a stockholder of stock of one of the pipe line companies would have diminished his proportionate interest in the enterprise.

The Baltimore & Ohio stock was fruit of the Union Pacific enterprise. It was absolutely separated from the Union Pacific corporation and turned over to the stockholder for his own individual use. In the case at bar the oil companies first turned over from a quarter to a half of their capital assets to the new pipe line companies—not to the stockholders of the oil companies. Up to this point and to that extent the transaction deprived the stockholders of their capital interest in these business

assets. The new stock was not fruit, at the most it stood for the capital assets in which, but for that stock, the stockholders would have been deprived of their interest. The receipt of the stock of the Baltimore & Ohio by the stockholders of the Union Pacific could not simply preserve to them their pre-existing stockholders' interest in the Baltimore & Ohio properties, because they had never had any such interest.

The significance in the case at bar of the distinction between liquid corporate assets and business plant constituting an integral part of the enterprise is far-reaching. The Government's claim is that the stockholder received "income derived from dividends" within the meaning of the Income Tax Law of 1913. In the case at bar the facts, which no refined reasoning nor metaphysical analysis can obscure, are that the entire pipe line business of each oil company was disposed of. Even if we should assume for purposes of argument (what we expressly deny) that the stock of the pipe line companies constituted the proceeds of the disposition of the pipe line properties and was distributed by the oil companies to the stockholders, we are nevertheless forced to the conclusion that it constituted capital and not income.

We have frequently stated that the receipt by the stockholders of the oil companies of the stock of the pipe line companies cannot be deemed to constitute the receipt of income because in their hands those shares of stock merely preserved to them the proportionate interests in the enterprise which they had held before the transfer of

the pipe line properties. The point which we are making here is that, entirely regardless of this feature of the transaction, the receipt of the stock of the pipe line companies could not constitute income because, ignoring the fact that it merely evidenced an interest in the pipe line properties which the stockholders of the oil companies had formerly held, it was still capital and not income in their hands because it constituted the proceeds of the disposition by the corporation of business plant which was an integral part (in one case approximately a half, in the other approximately a quarter) of the corporate enterprise—proceeds which must in spite of the existence of surplus represent, not a *return on a capital investment* but a *refundment of that investment*.

In the branch of the law which deals with the relative rights of life tenant and remainderman this same question has arisen, and the following summary of the state of the authorities has recently been made by the Supreme Court of Rhode Island in *Rhode Island Hospital Trust Company v. Bradley*, 41 R. I. 174, 197; 103 Atl. 486, 494:

“We find that almost without exception in all these jurisdictions, whatever the rule may be governing the rights of life tenants and remaindermen as to ordinary cash dividends earned and distributed at certain intervals by corporations doing business in the regular course, or as to extraordinary dividends, whether in cash or stock, the distribution of sums of money arising from a conversion of capital into money, in either partial or gradual or complete liquidation of capital

value, has been held to belong to the corpus of the trust fund as capital for the benefit of the remaindermen, and that the life beneficiary has only the right to such income as shall arise upon the reinvestment of the funds so received."

The Supreme Court of Rhode Island was referring to "capital" in the sense of properties essential to the conduct of the business and the realization of earnings.

The underlying principle of this line of decisions is that while *prima facie* a dividend in cash from the proceeds of the sale of corporate property is income, that presumption is rebutted when it appears that the property is something more than mere property and is an essential element in the conduct of an integral part of the business. In the one case it is proper to treat the distribution as made out of surplus; in the other it would be in obvious disregard of the facts to do so.

In *Matter of Rogers*, 161 N. Y. 108, the distinction was drawn between such capital business assets as properly belong to the remainderman and such other assets as may properly be distributed to the life tenant as a part of surplus. The Court pointed out that the proceeds of the disposition of a manufacturing plant and the necessary tools, fixtures and machinery which constituted an essential part of the business assets was capital, whereas the proceeds of the sale of Government bonds, railroad stocks and lands in western states fell in a different category and were properly allocated to the life tenant.

In *Heard v. Eldredge*, 109 Mass. 258, the Court clearly pointed out that the rule applies when the property disposed of is an integral part, although not the whole, of the business property. At page 260, the Court said:

“If the City had taken the whole of the company’s land, it would be plain that they had taken its capital. A dividend of the money received for it would be a dividend of capital, of which the tenant for life ought to have the income only. The taking of a large part of the land makes no substantial difference in principle.” * * * “It is clearly a dividend of a part of the capital;
* * *

Similarly, in the law of corporations the distinction is recognized between the mere disposition of property and the disposition of an integral part of the business of the corporation.

In *Rollins v. Clay*, 33 Maine 132, Shepley, C. J., speaking for the Supreme Judicial Court of Maine, said, at page 139:

“The directors of a corporation are authorized, by virtue of their office, to transact its ordinary and customary business, unless the charter or by-laws otherwise determine. But they are not authorized, without some special authority, to make sale of that portion of its estate or property essentially necessary to be retained to enable it to transact its customary business.”

See also *Matter of Timmis*, 200 N. Y. 177.

The recognition of this principle in the law of taxation is essential for two reasons: first, because the Income Tax Law of 1913 and all of the subsequent tax laws exempt from the normal tax income derived from dividends, since the earnings from which the dividends are paid have already been subjected to taxation in the hands of the corporation, whereas in the case of income derived from the realization of a gain or profit, both the surtax and the normal tax must be paid; secondly, because the amount of the capital investment of stockholders in the same corporation varies according to the price paid for the stock. Therefore, when the capital investment is refunded, it is not proper to tax the stockholder who has purchased at more than par upon the entire amount of his pro rata share of the surplus. Conversely, it is not sufficient to tax the stockholder who has purchased at less than par, upon *only* his pro rata share of the surplus. Both should be taxed upon the difference between the price paid for the stock and the amount received in liquidation. On that amount the stockholder should be subject to both the additional tax and the normal tax.

The distinction is observed in the Income Tax Law of 1918, which provides in subsection (c) of Section 201,

“Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.”

This distinction has been recognized by this Court in

Lynch v. Turrish, 247 U. S. 221. In that case the essential facts were that shortly after March 1, 1913, a corporation sold all of its assets and distributed the cash to its stockholders in the form of dividends, each stockholder receiving twice the par value of his stock. A stockholder brought suit to recover back the tax exacted upon the difference between the par value of his stock and the amount of cash received. It appears from the briefs that he had paid exactly par for his stock. The Government advanced two theories: (1) that the stockholder had realized a gain or profit to the extent of the difference between the price paid for the stock and the amount received in liquidation, and (2) that the amount distributed by the corporation in excess of the par value of the stock constituted a dividend. Mr. Justice McKenna's opinion consists almost entirely of a refutation of this first theory of the Government and this portion of it is therefore irrelevant in the case at bar. It was in connection with this theory that the question of the amount of the surplus which existed on March 1, 1913, was material.

The fact that the surplus had been accumulated prior to March 1, 1913, was properly treated as immaterial so far as the theory that the stockholder had received a dividend was concerned, because this Court held in *Lynch v. Hornby*, 247 U. S. 339, coincidentally argued and decided, that a cash dividend, although extraordinary in amount, consisting of surplus accumulated prior to March 1, 1913, paid by a corporation which thereafter

continued in business, was taxable as income derived from dividends within the meaning of the Act of 1913.* The theory of the Government that the stockholder had received a dividend was disposed of by this Court with the brief statement that the distribution "was a single and final dividend in liquidation of the entire assets and business of the company, a return to him of the value of his stock upon the surrender of his entire interest in the company."

The basis of the decision in the *Turkish* case is that the distribution to the stockholders of the proceeds of the disposition of all of the corporate assets is not a return to the stockholder on his capital investment but is a *refundment* of his capital investment—that what he receives is not income but capital. It is the proceeds of what is in the truest sense capital. Therefore, the stockholder has not received "income derived from dividends" within the meaning of the Income Tax Law of 1913.

*If the Government should attempt to argue that the date of the accumulation of surplus has any importance we call to the attention of the Court the admitted facts that: In the case of The Ohio Oil Company all or at least a substantial part of the pipe line property was owned on March 1, 1913; that it did not increase in value, at least not to the extent of the par value of the stock of the pipe line company between that date and the date of the transfer; and that the increase in the book surplus of the oil company between these dates amounted to only \$14,824,680.86 while the aggregate market value of the stock of the pipe line company on the basis of which the Government claims that the stockholders are taxable amounts to \$26,000,000. In the case of The Prairie Oil & Gas Company approximately 75% of the pipe line property was owned on March 1, 1913, and was acquired with money paid out of funds composed in part of the proceeds of the sale of stock and bonds and in part of earnings; that it did not increase in value, at least not to the extent of the par value of the stock of the pipe line company between that date and the date of the transfer; and that the increase in the book surplus of the oil company between those dates amounted to only \$19,704,894.85 while the aggregate market value of the stock of the pipe line company on the basis of which the Government claims that the stockholders are taxable amounts to \$39,960,000.

It happened that in the *Turrish* case the corporation disposed of all of its property. But the principle involved is the same when only a part is disposed of, if the part disposed of constitutes an integral income producing business, and it has been so held in the life tenant and remainderman cases referred to above.

In *Lynch v. Hornby*, 247 U. S. 339, the argument was made that dividends do not constitute income because "every dividend distribution diminishes by just so much the assets of the corporation, and in a theoretical sense reduces the intrinsic value of the stock."

This Court realized that there might be cases in which it would appear that the dividend was of such a nature that regard being had to that argument Congress would be presumed not to have intended to impose a tax thereon. Therefore, in holding in the *Hornby* case that the dividends there involved were taxable the Court expressly limited its decision to dividends declared "in the ordinary way of business." Mr. Justice Pitney, speaking for the Court, said:

"In our opinion, Congress laid hold of dividends paid in the ordinary course as *de facto* income of the stockholder, without regard to the ultimate effect upon the corporation resulting from their payment. Of course we are dealing here with the ordinary stockholder receiving dividends declared in the ordinary way of business." (247 U. S. 346.)

* * * * *

"In short the word 'dividends' was employed

in the Act as descriptive of one kind of gain to the individual stockholder; dividends being treated as the tangible and recurrent returns upon his stock, analogous to the interest and rent received upon other forms of invested capital." (247 U. S. 344.)

* * * * *

"Dividends are the appropriate fruit of stock ownership, are commonly reckoned as income, and are expended as such by the stockholder * * *." (247 U. S. 344.)

We believe that in thus limiting its decision this Court had in mind precisely the distinction which we are attempting to make and that it appreciated that cases would arise in which any broad rule that every distribution by a corporation having a surplus constitutes a taxable dividend would lead to great injustice and utterly illogical results.

Under the principles laid down in the *Hornby* and *Turrish* cases there is no room for the argument that the stockholders of the oil companies received "income derived from dividends." The transaction was one in connection with which the existence of surplus was purely accidental. It was one the authorization of which lay beyond the power of the directors, in whose absolute discretion rests the payment of ordinary dividends. It was not a distribution of liquid treasury assets or the proceeds of the sale of ordinary property in the ordinary course of business. It was not recurrent in nature, and would not have been expended as income. It was, on the con-

trary, a single and isolated disposition of one of the two distinct businesses conducted by the oil companies—a disposition necessitated by conditions over which the corporation had no control. Viewing the transaction in its true light, the stockholders of the oil companies received nothing which they did not have before. Viewing it as the Government would have us view it, they received nothing except in refundment of or substitution for that which the oil companies had disposed of. In no view of the transaction which can be suggested did they receive a dividend or income in any form.

POINT FIVE.

No part of the cause of action of plaintiffs-in-error in No. 536 is barred by the provisions of Sections 3226 and 3227 of the Revised Statutes.

The Government asserts that the claim of plaintiffs-in-error in No. 536 to recover back \$31,398.34, being part of a payment made by their testator on August 16, 1917, and representing the alleged tax upon the par value of the stock of the pipe line companies, is barred by Sections 3226 and 3227 of the Revised Statutes. The facts are that the appeal to the Commissioner of Internal Revenue was perfected on November 10, 1917, that the claim was rejected on April 22, 1919, and that suit was commenced on March 1, 1921.

The Government asserts that the cause of action of

plaintiffs-in-error became barred on May 10, 1920, *i. e.*, two years and six months after the appeal to the Commissioner. We submit that there is no merit in this assertion and that the plaintiffs-in-error had until two years after the rejection of the claim on April 22, 1919, within which to commence suit.

Sections 3226, 3227 and 3228 of the Revised Statutes establish a scheme of things whereby taxpayers may have their rights adjudicated in the courts. The scheme contemplates that before a taxpayer may bring suit he must present his claim to the Commissioner of Internal Revenue as the central head of the Bureau, so that uniformity in the application and enforcement of the internal revenue laws may be obtained. It also very properly imposes some limitation upon the time within which the taxpayer may act. Thus it is required that the taxpayer must present his claim to the Commissioner of Internal Revenue within two years after the payment was made. It is further required that suit must be brought within two years after the date of the decision of the Commissioner of Internal Revenue. Those provisions and requirements are sufficient to constitute a complete scheme of things, except for the possibility that the Commissioner of Internal Revenue might fail to decide the appeal at all or might delay deciding it for so long a time that a considerable hardship would be imposed upon the taxpayer. Accordingly, it was necessary to insert some provision whereby the taxpayer would have the right to bring suit *without waiting for*

a decision by the Commissioner, if the Commissioner delayed for an unreasonable length of time. Thus the statute provides that, if the decision of the Commissioner is delayed for more than six months, the taxpayer may sue "without first having a decision of the Commissioner." It was, of course, necessary to impose some limitation upon the time within which the taxpayer might bring suit, if he chose to bring suit, without first having a decision of the Commissioner, and the statute provides that that limitation is also two years.

Sections 3226, 3227 and 3228 are set forth in full in Appendix C, page 95. Briefly, Section 3226 provides that no suit shall be maintained until appeal has been made to the Commissioner of Internal Revenue *and a decision of the Commissioner of Internal Revenue had therein*, and contains the proviso that if the decision is not had within six months, then the suit *may be brought without first having a decision of the Commissioner*, at any time within two years after the expiration of the six months.

Section 3227 provides that no suit shall be maintained in any court unless brought within two years after the cause of action accrued. Section 3228 provides that all claims must be presented to the Commissioner within two years after the tax was paid.

The essential distinction is that there are two distinct sets of conditions under which the taxpayer may sue. First, he may sue without waiting more than six months for a decision by the Commissioner, in which case he must bring suit within two years and six months

after the claim was filed. Second, he may wait for a decision by the Commissioner, and in that event he must bring suit within two years after the decision is rendered.

The Government asserts that when the Commissioner has failed to give a decision within six months of the filing of the claim, the taxpayer has no option to wait any longer for a decision by the Commissioner but must be treated as having automatically fallen within the first set of conditions.

It has already been decided by this Court, in cases involving the construction of similar statutes, that the theory of the Government is unsound, and that if the taxpayer does not elect to treat the delay of the Commissioner as creating a cause of action but prefers to wait until a decision is rendered, the only limitation which applies is that which begins to run at the date of the decision by the Commissioner.

In *Aranson v. Murphy*, 109 U. S. 238, a statute (13 Stat. 214) provided that no suit should be maintained for the recovery of customs duties until the decision of the Secretary of the Treasury should have been obtained, "unless the decision of the Secretary of the Treasury shall be delayed more than ninety days from the date of such appeal." The same statute provided that suit must be brought within ninety days after the decision of the Secretary of the Treasury. There was no limitation upon the time within which suit might be brought if the decision of the Secretary of the Treasury was delayed for more than ninety days, and the taxpayer brought

suit before a decision was rendered. It was argued, however, that the New York statute of limitations applied and began to run ninety days after the appeal to the Secretary of the Treasury. This Court held that "Congress having undertaken to regulate the whole subject, its legislation is necessarily exclusive" and that therefore the New York statute of limitations did not apply. In reaching this conclusion, this Court clearly indicated that the scheme of the Federal statute contemplated that the taxpayer might either treat a ninety-day delay as an adverse decision and bring suit without waiting for the Secretary of the Treasury to act, or else might wait for a decision, in which case he might bring suit at any time within ninety days after the decision.

This Court said, at page 242, that no cause of action accrued until a decision was made by the Secretary of the Treasury, and that the suit was barred unless brought within ninety days thereafter,

"but, with the proviso, that if such decision is delayed more than ninety days after the date of his appeal, it is at the claimant's option either to sue, pending the appeal, treating the delay as a denial, or to wait until a decision is in fact made, and then sue within ninety days thereafter.

"It cannot be that he is obliged, in case for any reason a decision at the Treasury Department is delayed beyond the appointed time, to treat the delay as an adverse decision and to bring his suit while the matter is still *sub judice*.

* * * * *

"The whole purpose of the saving in his favor evidently is, that he shall not be required to wait longer than ninety days after his appeal for an adjudication. There is nothing to forbid his waiting, without suit, as long as he has reason to expect a favorable decision upon his appeal."

James v. Hicks, 110 U. S. 272, involved the construction of Section 19 of the Act of July 13, 1866, (14 Stat. 152), which was the direct predecessor of Sections 3226 and 3227 of the Revised Statutes. It provided that no suit should be maintained until an appeal had been taken to the Commissioner of Internal Revenue and his decision had thereon, and that such suit must be brought within six months after the decision,

"Provided, That if said decision shall be delayed more than six months from the date of such appeal, then said suit may be brought at any time within twelve months from the date of such appeal."

The Government argued that, the decision of the Commissioner having been delayed more than six months and suit not having been brought by the taxpayer within twelve months of the date of the appeal, the taxpayer's cause of action was barred by the proviso. The taxpayer's answer was that he had waited until the Commissioner had given his decision and had brought suit within the time limited for the commencement of an action under such conditions. The Government's argument, which is precisely the argument which it is making

in the case at bar, was rejected by this Court, which said, at page 275:

“It is argued now, by the Solicitor-General, that the action was barred by the Act of 1866, because not brought within twelve months from the date of the appeal. The terms of that act require, as conditions precedent to the right to bring any such suit, first, an appeal to the Commissioner of Internal Revenue; second, a decision thereon by him; and not then unless it shall be brought within six months after such decision, or within that time after the act takes effect. The proviso is, that if the decision is delayed more than six months from the date of the appeal, the suit may be brought at any time within twelve months from the date of such appeal, that is, although no decision may have, in the meantime, been made. Such was the construction of similar provisions in Sec. 2931, Rev. Stat., adopted in *Aranson v. Murphy*, 109 U. S. 238. The plaintiff is not bound to sue until a decision on the appeal has actually been made, but must sue within six months thereafter. If he does not choose to wait for a decision, he may nevertheless bring suit before it is made if it is delayed more than six months from the date of the appeal, provided, however, in that case, he sues within twelve months, from the date of the appeal.

“In the present case, the plaintiff chose to wait, as he had the right to do, until a decision upon his appeal had been made.”

If, under the proviso in the Act of 1866, the taxpayer had the right to wait for a decision by the Commissioner and base his cause of action upon the rejection of his claim, there is not even room for argument that the proviso in Section 3226 deprives him of that right. In fact the insertion in Section 3226 of the words "without first having a decision of the Commissioner" clearly indicates that Congress intended to eliminate the possibility of argument by stating expressly that it is only when suit is brought "without first having a decision of the Commissioner" that the limitation of time stated in the proviso is to apply.

In *Merck v. Treat*, 174 Fed. 388, the Circuit Court of Appeals for the Second Circuit has construed the proviso in Section 3226 in accordance with the principles laid down in *James v. Hicks*. The opinion is clear and convincing, and emphatically refutes every argument of the Government. It contains the following concise statement of the matter, at page 390:

"The practice, as we construe the statute, is plain and simple. The party whose property has been, as he thinks, wrongly taken by the collector appeals to the Commissioner. If the latter official renders a decision against him he must bring suit within 2 years from the date of such decision. But the decision may be unreasonably delayed and the claimant may thus be deprived of the use of his money for an indefinite period. To guard against such injustice the option is given, if he sees fit to exercise it, of beginning his suit

after the expiration of 6 months from the date of the appeal. The collector needs no protection of this kind, he has possession of the money and the Commissioner, if he so desires, can set the 2 years' running by a decision on the same day as the appeal. The citizen whose property has been taken does need protection, for, as has been stated, without the proviso he is absolutely remedyless if the Commissioner neglects to decide. It is this protection which the proviso gives. As is pointed out in the plaintiff's brief, if these actions must be brought within the 2 years and 6 months the result will be that the courts will be overwhelmed with unnecessary litigation. Especially is this true where, as in the case at bar, a new act is to be construed."

In its brief in the District Court the Government quoted from *Maryland Casualty Company v. United States*, 251 U. S. 342, as follows:

"This statement shows the right of the claimant was plainly barred by its failure to appeal to the Commissioner of Internal Revenue, Rev. Stats. Sec. 3226 (this is fundamental, *Kings County Savings Institution v. Blair*, 116 U. S. 200), and also by its failure to institute suit within two years after the cause of action accrued (Rev. Stats. Sec. 3227)." (251 U. S. 354.)

The facts were that the claim for refund *was not filed with the Commissioner* within the time limited by the statute. Therefore no cause of action ever accrued.

The Government would have us read this quotation as stating: "The claimant never had any cause of action because he failed to appeal to the Commissioner within the statutory period, and his cause of action was barred by his failure to bring suit within the time limited after his cause of action accrued." Clearly, this Court did not intend to make any such meaningless statement. Apparently this Court added the words "and also by its failure to institute suit within two years after the cause of action accrued" with the idea in mind that the two-year limitation on the right to bring suit ran from the date of the payment of the tax, which, of course, is not the case.

The Government relied upon *Christie Street Commission Company v. United States*, 126 Fed. 991. It appeared that the suit was brought more than two years but less than six years after the decision of the Commissioner of Internal Revenue, and the argument was made that Section 3226 did not apply, because the Tucker Act (24 Stat. 505) contained a provision that suits against the United States must be brought within six years. Therefore, the only question considered by this Court was whether the provisions of the Tucker Act repealed the provisions of Section 3226 for the purposes of a suit brought in the Court of Claims against the United States. Everything which this Court said in its opinion was said with that question alone in mind.

Another case which the Government cited is *Schwarzschild & Sulzberger v. Rucker*, 143 Fed. 656, a Cir-

cuit Court case, which contains no refence to *Arnson v. Murphy*, *James v. Hicks*, or *Merck v. Treat*, and which was apparently inadequately presented to the Court.

CONCLUSION.

It is submitted that the judgment of the District Court in both cases should be reversed, for the reason that on principle and under the decisions of this Court, when the oil companies, pursuant to business necessity, divided the two branches of their business so that one should be conducted by the original oil companies and one by the newly organized pipe line companies, and the capital interest of the stockholders was preserved by the issue or distribution to them of the stock of the pipe line companies—the transaction, from the point of view of the corporation, was a transfer of a distinct business to another corporation, which bore no resemblance in purpose or method of consummation to the payment of a dividend, and, from the point of view of the stockholder, was an exchange or conversion of a capital investment formerly represented by the stock of a single corporation conducting two distinct businesses into a capital investment represented by the stock of two corporations each conducting one of those businesses; and that the rules and principles established by this Court repudiate the metaphysical theory of the Government that by that transaction surplus of the oil companies was distributed to the stockholders in the form of a dividend constituting income within the meaning of the Income Tax Law of 1913 and the Sixteenth Amendment.

GEORGE WELWOOD MURRAY,

HARRISON TWEED,

Counsel for Plaintiffs-in-Error.

MURRAY, PRENTICE & ALDRICH,

Attorneys for Plaintiffs-in-Error.

APPENDIX A.

SECTION E OF THE INCOME TAX LAW OF 1913.

E. That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable, on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid, and interest at the rate of 1 per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons. * * *

APPENDIX B.

ARTICLE 1568 OF TREASURY REGULATION 45.

ART. 1568. *Determination of gain or loss from subsequent sale.*— * * * For example, if 100 shares of common stock, par value \$100, are exchanged for 50 shares of preferred and 50 shares of common each of \$100 par value, and the cost of the old stock was \$250 per share, or \$25,000, but the market value of the preferred on the date of the exchange was \$110 per share, or \$5,500 for the 50 shares, and the market value of the common was \$440 per share, or \$22,000 for the 50 shares of common, one-fifth of the original cost, or \$5,000, would be regarded as the cost of the preferred, and four-fifths, or \$20,000, as the cost of common. The same method of computation should be used in the case of stock acquired prior to March 1, 1913, in order to ascertain the proportion of such value to be allocated to each class of new securities on that date and the taxable gain or deductible loss should thereafter be computed in accordance with article 1561 as amended.

* * *

APPENDIX C.

SECTION 3226, SECTION 3227 AND SECTION 3228 OF THE
REVISED STATUTES.

SECTION 3226. No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein: *Provided*, That if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought, without first having a decision of the Commissioner at any time within the period limited in the next section.

SECTION 3227. No suit or proceeding for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority or of any sum alleged to have been excessive or in any manner wrongfully collected shall be maintained in any court, unless the same is brought within two years next after the cause of action accrued: *Provided*, That actions for such claims which accrued prior to June six, eighteen hundred and seventy-two, may be brought within one year from

said date; and that where any such claim was pending before the Commissioner, as provided in the preceding section, an action thereon may be brought within one year after such decision and not after. But no right of action which was already barred by any statute on the said date shall be revived by this section.

SECTION 3228. All claims for the refunding of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, must be presented to the Commissioner of Internal Revenue within two years next after the cause of action accrued: *Provided*, That claims which accrued prior to June six, eighteen hundred and seventy-two, may be presented to the Commissioner at any time within one year from said date, but nothing in this section shall be construed to revive any right of action which was already barred by any statute on that date.

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In the Supreme Court of the United States.

OCTOBER TERM, 1921.

JOHN D. ROCKEFELLER, PLAINTIFF IN error. v. THE UNITED STATES OF AMERICA.	}	No. 535.
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THE NEW YORK TRUST COMPANY AND Edith Hale Harkness, executors of the last will and testament of William L. Harkness, deceased, plaintiffs in error, J. WILLIAM H. EDWARDS, COLLECTOR OF United States internal revenue for the Second District of New York.	}	No. 536.
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*IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF NEW YORK.*

BRIEF FOR DEFENDANTS IN ERROR.

STATEMENT.

These cases are before the court on writs of error to the United States District Court for the Southern District of New York, and involve the taxability, under the sixteenth amendment to the Constitution

and the provisions of Section II of the income tax act of October 3, 1913 (38 Stat. 114, 166), of a distribution by the Ohio Oil Company to its stockholders of stock in the Illinois Pipe Line Company and by the Prairie Oil and Gas Company to its stockholders of stock in the Prairie Pipe Line Company.

The first action is a suit instituted by the United States on December 20, 1920, in the United States District Court for the Southern District of New York, to recover \$292,678.78, with interest, additional income tax alleged to be due from John D. Rockefeller for the year 1915. Cross motions for judgment on the pleadings, consisting of the complaint, amended answer and plaintiff's demurrer to the affirmative defense set up in the amended answer, were filed by both plaintiff and defendant below. (No. 535, Rec., pp. 32-33.) The district court sustained the demurrer to the affirmative defense, granted the motion of the United States for judgment, and directed final judgment on September 9, 1921, for \$383,891.59. (No. 535, Rec., pp. 38-40.) Petition for writ of error was filed September 10, 1921, and was allowed the same day. (No. 535, Rec., pp. 40, 41, 46.)

The second action is a suit instituted on March 1, 1921, by the executors of the estate of William L. Harkness, deceased, against the collector of internal revenue for the second district of New York, to recover \$44,413.91, with interest, individual income tax paid for the year 1915 and alleged to have been erroneously and illegally assessed and collected. A

demurrer was filed on behalf of the collector to the amended complaint, which set out substantially the same facts contained in the affirmative defense of the answer filed in the Rockefeller case. (No. 536, Rec., p. 29.) The district court sustained the demurrer and gave final judgment on September 9, 1921, dismissing the complaint and awarding costs to the collector. (No. 536, Rec., pp. 36-37.) Petition for writ of error was filed September 10, 1921, and was allowed the same day. (No. 536, Rec., pp. 37, 41, 44.)

Because of the constitutional questions involved, direct writs of error to the district court were sued out under section 238 of the Judicial Code.

II.

THE FACTS.

These two cases involve the taxability of dividends declared and paid by two oil companies, in each of which the plaintiffs in error were stockholders. The facts in both transactions, while differing in minor details, are, in principle, not dissimilar to the facts in the case of *United States v. Phellis* (No. 260, October term, 1921).

The essential facts in the two cases now under consideration (eliminating the unimportant details, which are stated with substantial accuracy in the brief for the plaintiffs in error) are as follows:

The plaintiffs in error received from the Ohio Oil Company and the Prairie Oil & Gas Company certain shares of stock in two other corporations *as a dividend*

distribution, and the circumstances under which these distributions were made in each company and with respect to both plaintiffs were as follows:

THE OHIO OIL COMPANY.

In the year 1914 the Ohio Oil Company was engaged in producing oil and transporting it by pipe lines which it owned and operated. The capital stock of the company amounted to \$15,000,000, divided into 600,000 shares of the par value of \$25 each. The company had been very prosperous and, as in the Phellis case, *had a surplus far in excess of its capital*. This surplus on December 31, 1914, before the transaction hereinafter referred to, amounted to \$68,849,427.49, more than four times the capital of the company.

When this court, on June 14, 1914, determined that their pipe lines were subject under a recent act of Congress to the supervision and regulation of the Interstate Commerce Commission (*United States v. Ohio Oil Company*, *United States v. Prairie Oil & Gas Company*, 234 U. S. 548), the Ohio Oil Company determined that it would free its oil business from such supervision by selling its pipe lines to another corporation. (Plaintiffs in error's brief, p. 5.)

Accordingly, there was formed a new corporation, called the Illinois Pipe Line Company, with an authorized capital stock of \$20,000,000, divided into 200,000 shares of the par value of \$100 each. An arrangement was then effected between the two corporations whereby, on November 30, 1914, the

pipe line company offered to pay to the Ohio Oil Company, in purchase of its pipe lines, the sum of \$20,000,000 in cash, or in cash and notes, or in the paid-up capital stock of the pipe line company. (Case 535, Rec., p. 14, par. 24.)

On December 21, 1914, by resolutions of the stockholders of the oil company, the offer of the pipe line company was accepted. Before the transaction was consummated, it was agreed between the two corporations that the oil company would accept payment for its pipe lines in the capital stock of the pipe line company, and the transfer was accordingly made on January 1, 1915. *By resolution of the board of directors of the oil company a pro rata distribution of the stock of the pipe line company was then made among the stockholders of the oil company.* (Rec., 535 p. 15, par. 28; Rec., 535, pp. 30-31, Exhibit M.)

Accordingly, the pipe line company issued to the oil company a certificate representing its entire stock of 200,000 shares, and thereupon the oil company retransferred the certificate to the pipe line company with instructions to divide it into new certificates so that each stockholder of the oil company should receive certificates representing his pro rata share of the stock of the pipe line company now owned by the oil company and distributed by the oil company among its stockholders.

When the transfer was completed the pipe line property was entered as an asset of the pipe line company and the shares of the pipe line company were entered as an asset of the oil company, and on

January 31, 1915, the sum of \$20,000,000 was charged off on the books of the oil company, under profit and loss, as "*Dividend, \$20,000,000.*" (Rec., pp. 15-16; par. XXX.)

This distribution of the new asset of the oil company in no respect impaired its capital. Its surplus at the dates hereinafter mentioned was as follows (No. 535, Rec., p. 16; par. XXX.):

March 1, 1913.....	\$54, 024, 746. 63
December 31, 1914, before the sale of the pipe-line companies.....	68, 849, 427. 49
January 31, 1915, after the sale of the pipe lines and payment of the dividend.....	58, 658, 015. 35

The stock of the oil company and the pipe-line company sold above par immediately after the sale and transfer. (No. 535, Rec., p. 17; par. XXXIII.) It thus appears that the distribution in question, characterized by the oil company itself as a "*dividend,*" was a *partial distribution of an existing surplus, and therefore of earnings.*

THE PRAIRIE OIL & GAS COMPANY.

The facts as to the Prairie Oil & Gas Company are substantially the same as in the Ohio Oil Company, changing unessential details of dates and amounts.

The oil company was incorporated under the laws of Kansas with a capital stock of \$18,000,000, divided into 180,000 shares of the par value of \$100 each. *It, too, had a large surplus, which was four times as great as its capital stock, at the time the transaction hereinafter referred to took place.*

Actuated by the same motive as impelled the Ohio Oil Company to dispose of its pipe lines (*ante*, p. 4), the oil company on June 8, 1914, authorized their sale.

A new corporation called the Prairie Pipe Line Company was organized, with a capital stock of \$27,000,000, divided into 270,000 shares of the par value of \$100 each, and thereupon, on January 21, 1915, a contract was made between the two corporations whereby the oil company sold all its pipe lines to the pipe line company in consideration of the issue and delivery to the oil company of all the capital stock of the pipe line company. (Rec., 536, p. 4; pars. VI and VII.)

As there was some legal difficulty under the laws of Kansas in having the oil company hold the stock, even though temporarily, of the pipe line company, the directors of the former company, on January 21, 1915, directed that the certificates of the pipe line company, which were payable *to the oil company* for the pipe lines thus conveyed, should be divided pro rata among the stockholders of the oil company and should be issued by the pipe line company directly to them.

The transaction was completed on February 1, 1915, and the pipe line company thereupon, *at the direction of the oil company*, distributed among the stockholders of the latter certificates which, in the aggregate, represented the price which the pipe line company had paid to the oil company. Thereupon the pipe line property was entered as an asset of the

pipe line company and eliminated as an asset of the oil company.

On January 31, 1915, the oil company charged off, through its profit and loss account, the sum of \$27,000,000, which sum represented the value of the pipe line shares. (Rec., 536, pp. 5-7, pars. IX and X.)

The oil company suffered no diminution in capital by reason of this distribution. This surplus was on the dates following as follows:

March 1, 1913.....	\$40,387,029.69
January 31, 1915, before the transfer.....	60,071,924.54
February 1, 1915, after the transfer.....	38,851,907.06

It is unnecessary as to both the Ohio Oil Company and the Prairie Oil & Gas Company to refer further to the receipt by the plaintiffs below of their pro rata shares of the stock of the two pipe-line companies, for about this there is no dispute.

One difference remains to be noted between the two cases.

The Harkness estate case, on August 16, 1917, paid an income tax of which the sum of \$31,398.34 represented the tax upon the par value of the stock of the pipe-line companies. On November 10, 1917, the Harkness estate made a claim for a refund. The Commissioner of Internal Revenue did not pass upon such claim for six months thereafter, and upon the expiration of such six months the Harkness estate, under section 3226, Revised Statutes, had the right to bring suit. On June 30, 1919, an additional tax of \$13,015.57 was assessed upon the difference be-

tween the par value of the pipe-line stock and its market value.

Suit was not begun before March 1, 1921, a period of 3 years, 3 months, and 19 days from the filing of the claim and approximately 2 years, 9 months, and 19 days from the time when under section 3226 suit could have been brought.

Under section 3227, Revised Statutes, it is provided (section quoted hereafter, *post*, 28) that no such suit "shall be maintained in any court unless the same is brought within two years next *after the cause of action accrued.*"

Plaintiff claims, however, that although it could have brought its suit on and after May 10, 1917, in view of the fact that the Commissioner of Internal Revenue had not passed upon such claim, nevertheless its right to bring suit after the expiration of two years from that date was revived when, on April 22, 1919, the Commissioner of Internal Revenue did reject the claim. This question of the statute of limitations, which only arises in the Harkness Estate Case (No. 536), will be discussed hereafter. (*Post*, pp. 27-32).

III.

ARGUMENT.

These two cases do not differ in principle from the case of *United States v. Phellis* (No. 260, October term, 1921).

In all three cases there is presented a transaction where a corporation, *having a large surplus of earnings*, sells the whole or part of its assets to another corporation and receives as payment for such sale

the capital stock of the vendee corporation, which the vendor corporation thereupon proceeds, directly or indirectly, to distribute as a dividend among its own stockholders.

In each case it is apparent that the distribution was one of a surplus of accumulated earnings.

In none of the cases is there a suggestion of a liquidation of the corporation or an impairment of capital. After distributing such surplus, or a part thereof, among their stockholders in the form of the securities of another corporation and as dividends, *the capital of the corporations which declared the dividends remained intact.*

Moreover, in each case the stockholders of the corporations, which declared the dividend, did not surrender the whole or any portion of their stock in the declaring company but still retained their proportionate interest therein. They did receive the shares of stock of *another* corporation which were thus severed from the control of their own corporation and became their individual property to do with as they pleased. In each case the shares of stock received as a dividend were very valuable and readily salable in the market, so that these dividends in specie were the equivalent of cash and could be converted into cash *without any disturbance of the owner's proportionate interest in the company from which they were received.*

The incidental circumstance that by reason of a technicality the Prairie Oil & Gas Company did not itself formally or directly declare the dividend, but

simply directed its vendee to issue stock, which was the property of the vendor, directly to the vendor's shareholders is unimportant and does not require extended discussion. I can well invoke the principle, which my opponents in other connections so frequently invoke, that the court should look through the form of the transaction to its substance; and so regarded, it is obvious that the stock of the Prairie Pipe Line Company belonged as of right to the Prairie Gas & Oil Company, and it directed the pipeline company to issue the shares to the stockholders of the oil company, which was, in substance and fact, if not technically in form, a dividend.

In all three companies (the *du Pont* case, the *Ohio Oil* case, and the *Prairie Gas and Oil* case) the companies, which distributed these accumulated profits, themselves regarded it as a dividend. In the first two, they formally characterized the distribution as dividends, and in the third case (the *Prairie Oil Company*) they effectually did so when they charged off of their assets the value of the pipe-line shares.

The three cases being the same in principle, it will not be necessary for me to repeat the argument that I have already submitted to this court in the case of *United States v. Phellis* (No. 260, October term, 1921). *Mutatis mutandis*, everything that I have ventured to suggest in that case is applicable to the present case; and while I could in this brief restate that argument, it is well for counsel in the Supreme Court to avoid the sin of the Pharisees in making "vain repetitions, as the heathen do." (Math. vi, 9.)

I therefore rest my main argument in the instant cases upon my argument in the Phellis case.

If there be any difference in principle between the facts of these two cases and those in the *du Pont Powder Company* case, the facts now under consideration by the court are even stronger for the Government than in the *du Pont Powder Company* case. In that case the *du Pont Powder Company* sold *all* its assets to the new corporation; and had the former then proceeded to liquidate its affairs and dissolve as a corporation, a more serious question would have arisen, whether upon final liquidation that portion of the assets which were distributed—which undoubtedly represented accumulated earnings from operations—would or would not be taxable. Upon that question I need not express any opinion, for there was no liquidation or impairment of capital.

In the *Ohio* case and the *Prairie Gas* cases the oil companies only sold a part of their assets (the part being far less than its surplus), and then vendor and vendee corporations continued actively in their respective businesses, the one as a producer, and the other as a transporter, of oil.

The argument that was made in the *du Pont Powder Company* case, that this court must regard the New Jersey and Delaware *du Pont* corporations as substantially one corporation on the theory of practical identity of function and purpose, can not be applied to the two instant cases, for the very purpose of the transactions in the *Ohio Oil Company* case and the *Prairie Gas & Oil Company* case was to destroy

any possible identity by dividing between the two corporations two separate and distinct functions in the oil industry. Thenceforth, the oil companies had no further concern with transportation and the pipeline companies had no further connection with production.

In all three cases at the time of the sales there was a momentary identity of stockholding interests, but as the shares were bought and sold in the market the process of differentiation between the personnel of the stockholders began to take place; and for aught that now appears the preponderant element in the two corporations may now be entirely different.

It is unimportant whether this be so or not. The fact remains that the oil companies and the pipeline companies were each continued as going businesses, each having a separate function, and the identity which was *claimed* for the New Jersey and Delaware du Pont companies was, from the beginning and is now, wholly nonexistent as to the Ohio and Kansas companies.

As my argument in the *Phellis* case thus spares me the necessity of stating the Government's position, I might rest the case without any further trespass upon the patience of the court. This reply brief will simply make some passing references to the ingenious and elaborate brief which has been filed by the learned counsel for the Harkness estate and John D. Rockefeller.

That brief is full of verbal quibbles. (I say this with due respect to the learned counsel.) In its more than ninety pages it again and again states propositions to which I not only cheerfully assent but which, in fact, constitute the very propositions upon which I am relying for the Government, and thus I find that my learned antagonists appropriate my own arguments as if they were their own and as if they helped their case.

For example, point IV, pages 35-38, I accept *verbatim et litcratim*:

In the case of a stockholder, income is not realized unless and until something has been freed from corporate control and business risks and transferred to the absolute ownership of the stockholder.

That is precisely what I contend. For example, (1) if the New Jersey du Pont company had retained in its treasury \$120,000,000 of the stock of the Delaware du Pont company, or (2) if the Ohio Gas Company had retained in its treasury the stock which it received from the Illinois Pipe Line Company, or (3) if the Prairie Oil and Gas Company had retained in its treasury the stock of the Prairie Pipe Line Company, then I quite agree that such stock would not have been freed from the "corporate control and business risks" of those companies, respectively, and would not be taxable as income to the stockholder, for the simple reason that in those events he would have received no dividends.

Whenever, therefore, counsel for plaintiff in error use the general words "corporate control and business risks," let the Court ask itself to which corporation they are referring. They confuse the question by refusing to distinguish between two corporations, which they themselves made separate and distinct.

I will go further and will not dispute in each of these three cases that if each of the vendor companies had retained in its treasury the stock of the vendee company and had thereupon passed its value as accumulated earnings to capital account and had declared a stock dividend and issued to their stockholders new shares of stock to represent the new capitalization, no income tax would be payable under the decision of *Eisner v. Macomber* (252 U. S. 189), the authority of which decision I am not questioning.

Such a contingency is not the present case, for, in the precise language of the plaintiffs' proposition above quoted, the New Jersey powder company and the oil companies, in distributing among their stockholders the stock which those companies had received in payment of assets conveyed by them, did free such shares "from corporate control and business risks and transferred [them] to the absolute ownership of the stockholder."

Thenceforth, instead of having a mere stockholder's interest in accumulated earnings, upon which such stockholder could not realize until the board of directors chose to declare a dividend, the stockholder, after the payment of this dividend in specie, had the

shares thus received in his own absolute ownership, to do with as he pleased and with the ability to sell them without in any manner diminishing his own interest as a stockholder of the company from which he received them as a dividend.

The verbal quibble in the proposition that I have above quoted is in the words "corporate control." The plaintiffs can not deny that when the stockholder of the Ohio Oil Company, for example, received his shares in the Illinois Pipe Line Company as a dividend he thenceforth held these pipe line shares free from the "corporate control" of the *Ohio Oil Company*. Undoubtedly such stockholder held his new shares of another company subject to the corporate control of *that* company, but he no longer held them subject to the control of the *old* company that declared the dividends. In the last analysis the plaintiffs' contention is that whenever a stockholder receives as a dividend corporate shares *in another corporation* he does not receive income, simply because his corporate shares are subject to the corporate control of the company which issues them.

If that were so, the case of *Peabody v. Eisner*, 247 U. S. 347, would have been erroneously decided.

In that case the Union Pacific Railroad Company distributed among its stockholders shares of stock of the Baltimore & Ohio Railroad Company. When the Union Pacific stockholder received his Baltimore & Ohio stock he obviously did hold the stock free from the "corporate control and business risks" of the *Union Pacific Company*; but, in the very nature of the

case, he did not hold it free from such control and business risk of the *Baltimore & Ohio Company*.

If it served any useful purpose, I could follow this ingenious brief from page to page and show the verbal quibble (I say it respectfully) that again and again appears in such general expressions as "corporate control" and "business risks." In using these terms the plaintiffs consistently ignore the fact that they are dealing with two different and separate corporate entities, and that when these two entities came into existence the corporate control of the one was not the corporate control of the other, nor the business risks of the one the business risks of the other.

Relying upon the same verbal niceties, the learned counsel for the plaintiffs quote the five criteria which this court laid down in *Eisner v. Macomber*, *supra*, to determine what is a stock dividend, and in applying these principles, upon which counsel for the Government relies with the greatest confidence, there is again the same failure by the plaintiffs to distinguish between two different corporations.

Let us test this by quoting these five criteria:

1. *The effect of a stock dividend is to capitalize rather than to distribute corporate earnings.*

Of course it is. That is not this case. The vendor corporations did not capitalize their accumulated earnings but distributed a part of them among their own stockholders.

2. *The declaration of a stock dividend transfers nothing from the corporate assets and risks of the business to the individual use and ownership of the stockholder.*

Here, again, can it be questioned that, when Mr. Rockefeller received from the Ohio Oil Company, by way of dividend, his shares of stock of the Illinois Pipe Line Company, that such shares were transferred from the "corporate assets and risks of the business" of the Ohio Oil Company and inured "to the individual use and ownership of Mr. Rockefeller"? Of course, the verbal catch in the plaintiffs' argument, as previously stated, is that when Mr. Rockefeller received this dividend in the pipe line companies he still held his property subject to the corporate control of the pipe line companies, but it was not the pipe line companies that declared the dividends.

3. *The stockholder who has received a stock dividend can not pay a tax thereon without disposing of part of his capital investment.*

Mr. Rockefeller, if he elected to sell his pipe line dividends, would *not* dispose of his capital investment in the oil companies.

4. *The corporate entity can not be disregarded for the purpose of saying that the transfer from surplus to capital was the equivalent of a transfer to the stockholders.*

In these cases there was no transfer to capital, but wholly and purely a distribution among stockholders.

5. *The new stock issued as a stock dividend does not measure the extent to which the earnings accumulated by the corporation have enriched the stockholder.*

This obviously has no application to the cases at bar, for no one pretends that the vendor companies increased their capital stock or made a distribution of new shares thereof among their own stockholders. The use made by the plaintiffs of Mr. Justice Pitney's fourth and fifth tests is obviously wrong, because the learned justice was applying his remarks to a case where a corporation simply passed its surplus to capital and made an additional issue of *its own shares* to its stockholders.

Obviously, the language can have no application to cases as in the instant cases, where the corporations, which declared the dividends, did not increase their own stock or transfer their own surplus to their own capital, but, on the contrary, sold their assets in whole or in part to another corporation, received in lieu thereof its shares and distributed them as a dividend in specie among their stockholders.

The learned counsel for the plaintiffs (brief, p. 70) tries to make a distinction between liquid treasury assets and the proceeds of a disposition of a business plant.

The distinction is an unsound one, for when a corporation has a surplus, its assets are not allocated to original capital and surplus. No one has ever undertaken to say that *this* amount of securities or

that amount of cash or *this* piece of machinery or *that* piece of real estate is to be earmarked as a part of the surplus or as a part of capital.

Whenever property is distributed as a dividend, *ex necessitate rei*, it is allocated to, or more properly, is a part of surplus, for unless it be a distribution of surplus it would be an unlawful impairment of capital and a fraud upon the public. In making such distribution, the corporation can utilize any part of its assets, whether purchased by original capital or by earnings. The source of the dividend is unimportant, as long as it is a distribution of surplus and not of capital.

When, therefore, these corporations characterized these distributions of shares as "*dividends*" they necessarily characterized them as a part of their huge surplus of accumulated earnings.

When, therefore, there is a large surplus that is subject to dividend distribution it is for the management to say in what form it shall be distributed. It could be distributed in land, in tangible property, in securities, in cash, or in any other form of property.

There is and can be for the purposes of the tax gatherer no just distinction between so-called liquid assets and those which are not so liquid.

Unquestionably, where there is a question of impairment of capital a different question might arise, but that question is not now before this court.

They could have divided up kegs of powder or barrels of oil if they had pleased and the legal result would have been the same.

Even if this were not so, were not the shares of stock, that were distributed by all three companies among their stockholders, liquid treasury assets? Is there anything more liquid than a share of stock that you can sell on ten minutes' notice to a stock broker? Different questions undoubtedly arise where courts, in construing wills, must apportion the respective rights of life tenant and remainderman, but such cases are not analogous to the cases now under consideration. They turn upon the intention of testators upon wills of different phraseology.

Without more, I can rest my argument in all three cases upon my argument in the *Phellis* case. That brief represents my careful and mature thought upon the problem and points out the obvious dangers, which would result to the already overburdened Treasury of the United States, if the Government's contention in these three cases did not prevail, *and I know of no wider breach*, that could be effected in the income tax laws, than to permit the stockholders of these three companies, with their enormous accumulations of earnings (in each case far in excess of the original capital), to escape the income tax upon "dividends" which, disregarding all legal technicalities, they undoubtedly received.

IV.

THEORY OF "FREE ASSETS."

In their third point (plaintiffs' in error brief, p. 68), a point is made that the stock of the two pipe line companies did not become a part of the assets of the oil companies, respectively, or, to phrase it somewhat differently, they were not "free assets." I fail to see the relevancy of the suggestion, even if it were true; for the stockholders of the oil companies could, in the nature of the case, only receive the pipe line shares by reason of their stockholding interest in the oil companies. The method by which this was accomplished and the extent to which, if any, the oil companies were obliged to distribute, directly or indirectly, the pipe line shares among their stockholders, seem to me wholly unimportant. It is enough to say that they received these pipe line shares as a gain or as income, it being the increment of their stockholding interest in the oil companies.

As a matter of fact, I do not concede that these pipe-line shares were not "free assets." Previous to the transaction, the oil companies owned certain assets, and their stockholders owned interests in such assets. The oil companies could not dispose of the assets without due regard to the interests of their stockholders in such assets. The managements, respectively, sold these assets and accepted payment in pipe-line shares. They could have done so without any understanding as to the division of these

pipe-line shares among their stockholders, or they could do as they did, sell their assets for pipe-line shares, with the announced intention of distributing them among their shareholders. I fail to see how the essential nature of the dividend distribution can be in any manner affected or obscured by the mere method by which it was accomplished, and if there can be any doubt on this point, I need only refer to the case of *Marconi Wireless Telegraph Co. v. Duffy, Collector*, 273 Fed. 197, where, as here, a corporation which sold its property to another corporation, in exchange for the latter's stock, made an agreement whereby such stock was distributed by the vendee corporation directly to the stockholders of the vendor.

With reference to this transaction the court said, at pages 198-199—

In considering the question at issue we must not ignore the substantial difference between a corporation and its stockholders. *Gibbons v. Mahon*, 136 U. S. 549, 10 Sup. Ct. 1057, 34 L. Ed. 525; *Peterson v. Chicago, Rock Island & Pac. Ry. Co.*, 205 U. S. 364, 27 Sup. Ct. 513, 51 L. Ed. 841; *Lynch v. Hornby*, 247 U. S. 339-344, 38 Sup. Ct. 543, 62 L. Ed. 1149; *Eisner v. Macomber*, 252 U. S. 189, 214, 40 Sup. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. The property sold to Radio was the plaintiff's property, and could be sold only by it. To effect the sale the consent of the stockholders was necessary; but it, and not the stockholders, held the legal title, and it alone could vest such title in the purchaser. The stockholders eventually

would share in the consideration of the sale, but this could be brought about only by means of dividends or similar methods of distribution. The stock issued by Radio to the plaintiff's stockholders was the consideration for the property sold to it by the plaintiff. Had the plaintiff received the stock, as seemingly was originally contemplated, and disposed of it, whether to its stockholders or to other parties, a tax such as was here imposed would have had to be paid. Undoubtedly it was within the power of plaintiff upon obtaining the necessary authority, to direct Radio to issue the stock to its (plaintiff's) stockholders. But this authority—resolution of the plaintiff's board of directors—was nothing less than a transfer of plaintiff's rights to such shares of stock, and is covered by one of the quoted methods of transferring shares or certificates of stock taxable under subdivision 4, viz, a transfer of "rights to subscribe for or to receive such shares."

Prior to the passage of the corporation excise tax act of 1909 certain corporations leased all of their property in consideration of the payment of a fixed rental which, by agreement, was paid as dividends direct to the stockholders of the lessor corporation. After the passage of the act the question arose as to the taxability to the lessor corporations of the amounts paid as dividends to their stockholders by the lessee corporations. The courts uniformly ruled that the rents were constructively received by the

lessor corporations and the dividends paid by the lessee corporations were income of the lessor corporations.

Rensselaer & S. R. Co. v. Irwin, 239 Fed. 739; affirmed, 249 Fed. 726; petition for certiorari denied, 246 U. S. 671.

Blalock v. Georgia Ry. & Elec. Co., 246 Fed. 387.

West End St. Ry. Co. v. Malley, 246 Fed. 625; petition for certiorari denied, 246 U. S. 671.

In the *Rensselaer* case the Circuit Court of Appeals for the Second Circuit said:

It is true that the rent of its road does not go into the plaintiff's treasury and that it has no means of withholding the tax from it. It is also true that the rent reserved by the lease is paid by the lessee in fixed sums to third parties. All the same, the rent is the property of the plaintiff, and remains such, though by the terms of the lease paid out to others, whose rights are derived through it. While the rent is a debt of the lessee to the lessor, it is, as between the lessor and its stockholders, the lessor's income, out of which the dividends, if any, are to be paid.

The application of the rent under the lease is a mere labor-saving device, the effect being exactly the same as if it be paid to the lessor and by it paid out as far as necessary to bondholders for interest and the surplus in dividends to its stockholders. The description of the fixed sum to be paid by the lessee of 8 per cent to the lessor's stockholders as a dividend

shows that the payment is made as agent of the lessor.

Rensselaer & S. R. Co. v. Irwin, 249 Fed. 726, 727-728.

This case was followed by the Circuit Court of Appeals for the Fifth Circuit in the *Blalock* case, the court saying:

The difference between the way the rent under the lease here in question was paid and the way the same aggregate amounts would have been paid, if the lease had made the installments payable to the corporation itself, is one of method and not of substance. * * *

A creditor as truly receives payment of what is due him when, pursuant to his direction, the debtor makes payment to another as he does when payment is made directly to himself.

Blalock v. Georgia Ry. & Elec. Co., 246 Fed. 387, 389-390.

The *Rensselaer* case was again followed by the Circuit Court of Appeals for the First Circuit, the court saying:

The payments made to stockholders as above were made by the lessee for its use of the corporation's property, not of the stockholders' property. Though they have each an interest in said property, they have no direct interest such as makes them its owners.

The property has been put into the lessee's hands by the lessor corporation, and the payments to be made by the lessee for its use have been agreed on, not between the lessee and the lessor's stockholders, but between it

and the lessor corporation to which the property belongs. That agreement expressly refers to and treats these payments to stockholders as part of the agreed rent for the property. Under it no stockholder could assert rights as lessor for want of any such interest in the leased property as would have enabled him to lease it or agree upon a rent for it.

West End Street Ry. Co. v. Malley, 246 Fed. 625, 626-627.

Applying these principles to the case at bar, it is immaterial that the Prairie Pipe Line Company distributed its stock directly to the stockholders of the Prairie Oil & Gas Company. The transaction is the same as in the case of the Ohio Oil Company. Any difference was one of method, not substance.

V.

THE STATUTE OF LIMITATIONS.

The right of action in the *Harkness* case to the extent of \$31,398.34 is barred by the limitations of section 3227, Revised Statutes.

It only remains to discuss the question of the statute of limitations involved in the *Harkness* estate case, and to which I shall briefly refer in another point.

Whether the dividend in these cases is held to be income or not, the judgment of the court below in the *Harkness* case should be affirmed as to \$31,398.34, the right of action to recover this amount being barred by the statute of limitations.

On August 16, 1917, the decedent, William L. Harkness, paid under protest an income tax of which the sum of \$31,398.34 represented the tax upon the par value of the stock of the pipe-line companies. On June 30, 1919, an additional tax of \$13,015.57 was assessed and paid on the difference between the par value and the market value of the stock. On November 10, 1917, claim for refund of the original tax paid was filed with the Commissioner of Internal Revenue. This claim was rejected on April 22, 1919. Three years three months and nineteen days after the filing of this claim suit was instituted March 1, 1921, to recover \$44,413.91, which included both the sum of \$31,398.34 above referred to and the additional tax of \$13,015.57.

As to \$31,398.34, plaintiffs' right of action expired on May 10, 1920, under the following provisions of section 3227, Revised Statutes:

No suit or proceeding for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, shall be maintained in any court unless the same is brought within two years next after the cause of action accrued.

* * *

The date when the plaintiffs' cause of action "accrued," as limited in the above section, was May 11, 1918. This is fixed by the provisions of section 3226, Revised Statutes, as follows:

SEC. 3226. No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeals shall have been duly made to the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the commissioner has been had therein: *Provided*, That if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought without first having a decision of the commissioner at any time within the period limited in the next section.

The cause of action therefore "accrued" six months after the date of filing of the original claim for refund on November 10, 1917.

Sections 3226 and 3227 are made applicable to the income tax act of October 3, 1913, by Section II, paragraph L, thereof.

The obvious effect of these statutes is:

1. That if the commissioner rejects a claim for refund at any time within six months after the date the claim is filed, the taxpayer may immediately bring suit upon the rejection. The cause of action accrues then.

2. That if the commissioner delays his decision upon a claim for refund for more than six months,

the taxpayer may immediately bring suit without waiting for further action or decision by the commissioner. The cause of action accrues then, namely, six months after claim for refund is filed. To argue that a suit could be brought without an existing cause of action would be a legal anomaly.

The taxpayers seek to bring themselves within the two-year period allowed by section 3227 on the theory that their cause of action "accrued" on April 22, 1919, the date when the Commissioner of Internal Revenue actually rejected their claim.

The statute is not capable of such a construction. While section 3226 requires an appeal to the Commissioner of Internal Revenue, and provides that no suit shall be maintained until "a decision of the commissioner has been had therein," the present case is controlled by the proviso which follows:

Provided, That if such decision is delayed more than six months from the date of such appeal [which is precisely the present case], then the said suit may be brought without first having a decision of the commissioner.

In short, in cases falling within the proviso, where no decision of the commissioner is had within six months, the action of the commissioner is of no effect so far as the "accrual" of the claimant's cause of action is concerned. It is immaterial whether the commissioner may deny the appeal or take any action after the lapse of six months from the date the claim for refund is filed. The cause of action "accrues" at the time the plaintiff is given the right

to assert it by bringing suit, namely, six months after the filing of the claim without action thereon by the commissioner. Such is the plain wording of the statute and the limitation commences to run from that date.

The case of *Maryland Casualty Company v. United States* (251 U. S. 342) involved the recovery of corporation excise taxes under the act of 1909. Claim for refund was filed on April 30, 1915, and suit commenced in the Court of Claims on February 8, 1918. The Commissioner of Internal Revenue rejected the claim for refund after the lapse of six months from the date of filing, April 30, 1915.

On the question of limitation this court said, page 354:

This statement shows the right of the claimant plainly barred by its failure to appeal to the Commissioner of Internal Revenue (Rev. Stats. 3226) (this is fundamental, *Kings County Savings Institution v. Blair*, 116 U. S. 200), and also by its failure to institute suit within two years after the cause of action accrued (Rev. Stats. 3227).

The same construction was applied in the cases of *Schwarzschild & Sulzberger v. Rucker* (143 Fed. 656) and *Christie-Street Commission Co. v. United States* (126 Fed. 991, affirmed 136 Fed. 326).

The purpose of Congress in fixing a period of two years must have been to the end that the liabilities of the Government might be known as soon as possible after their accrual. The effect of the construction asked by the taxpayer in the case at bar is inconsistent

with such a general purpose. It means the extension of the period of limitation indefinitely where the Commissioner of Internal Revenue does not pass upon the claim for refund within six months. In other words, by not acting the commissioner can postpone the tolling of the statute indefinitely. This is not the plain and obvious purpose of sections 3226 and 3227, Revised Statutes. On familiar rules of construction, they must be read together and every section given effect to carry out the purpose of limiting the time for such suits.

VI.

CONCLUSION.

I have made no attempt to discuss all the verbal niceties in the lengthy and ingenious brief of the plaintiffs in error. To do so, would seem to me profitless. I may, however, call attention to the fact that counsel for plaintiffs in error, on more than one occasion in their brief, assume that I concede statements of fact or propositions of law, which, in point of fact, I do not concede.

For example (on p. 15): "In the case at bar, no claim is made that any gain or profit was realized by a stockholder of the oil companies."

This is the very opposite of my contention. On the contrary, I assert that they made gains and profits in comparison with which Monte Cristo's dream is dull and prosaic. Thus, Mr. John D. Rockefeller received, as his share of the dividends, pipe-line shares whose market value was as follows:

Illinois Pipe Line Company.....	\$6, 663, 965
Prairie Pipe Line Company.....	9, 942, 048
Total.....	16, 606, 013

See Mr. Rockefeller's allegation in his complaint, Paragraph VI. (Rec., p. 3.)

In view of this unquestioned fact, how counsel can impute to me a concession that John D. Rockefeller, for example, "made no gain or profit," I am at a loss to know.

Similarly (on p. 40), after stating that in the *Towne* case the "stockholder was no richer than before," adds "it is admitted that the same thing is true in the present case." I have already answered this contention by a reference to Mr. Rockefeller's little dividend.

Again (on p. 55), it is said: "It is admitted that if a stockholder sells any of the stock of the oil companies or of the pipe line companies, he is reducing the proportion of his interest, just as much as if he sells some of the stock issued to him as a stock dividend." Nothing of the kind is admitted. When the stockholder of the oil company sells the pipe line shares which he received as a dividend, he does not reduce his proportionate interest in the oil company.

However, I repeat that it is profitless to follow all the verbal, and, as I think, at times misleading, niceties in the plaintiffs' in error 90-page brief; for—

"In these nice sharp quilllets of the law,
Good faith, I am no wiser than a daw."

All that they have said can not obscure the inescapable fact that, while the oil companies might have held the pipe line shares as a part of treasury assets (in which event, these cases would not have arisen), they preferred to "cut a melon"—to use the picturesque phrase of Wall Street—and divide the pipe line shares, which represented a part of their great surplus, among their shareholders, and thus the stockholders, in form, substance, and fact, received a dividend.

Respectfully,

JAMES M. BECK,

Solicitor General.

CARL A. MAPES,

Solicitor of Internal Revenue.

NEWTON K. FOX,

ANDREW J. ALDRIDGE,

Special Attorneys, Internal Revenue.

OCTOBER, 1921.



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NOS. 536 AND 535.

Supreme Court of the United States,
OCTOBER TERM, A. D., 1921.

THE NEW YORK TRUST COMPANY and another, Exec-
utors of WILLIAM L. HARKNESS, deceased,
Plaintiffs-in-Error,

vs.

WILLIAM H. EDWARDS, Collector of Internal Revenue,
Defendant-in-Error.

JOHN D. ROCKEFELLER,
Plaintiff-in-Error,

vs.

UNITED STATES OF AMERICA,
Defendant-in-Error.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR
THE SOUTHERN DISTRICT OF NEW YORK.

Reply Brief for Plaintiffs-in-Error.

GEORGE WELWOOD MURRAY,
HARRISON TWEED,
Counsel for Plaintiffs-in-Error.



IN THE
Supreme Court of the United States
October Term A. D., 1921

THE NEW YORK TRUST COMPANY and EDITH
HALE HARKNESS, Executors of the Last
Will and Testament of William L. Hark-
ness, deceased,

Plaintiffs-in-Error,

against

No. 536.

WILLIAM H. EDWARDS, Collector of United
States Internal Revenue for the Second
District of the State of New York,

Defendant-in-Error.

JOHN D. ROCKEFELLER,

Plaintiff-in-Error,

against

No. 535.

UNITED STATES OF AMERICA,

Defendant-in-Error.

**REPLY BRIEF FOR PLAINTIFFS-IN-
ERROR.**

There is no constructive argument in the Government's brief which requires a reply. However, since our main brief assumed that the Government would address itself to the merits of the case, and it appears from its brief that it purposes not to do so, but to confine itself

to form and technicalities, it is believed that a few words in reply will help to clarify the issue.

I.

The Government's brief entirely disregards the substance of the transaction and deals only with technical matters of form.

This Court said in the *Macomber* case that "regard must be had to the very truth of the matter, to substance and not to form." Accordingly, in our main brief we called attention to the fact that the transaction must be viewed as an entirety, and that so viewed it consisted of a transfer of the pipe line properties to the pipe line companies by reason of business necessity, and the issue or distribution to the stockholders of the oil companies of the stock of the pipe line companies, in order that their interest in the entire enterprise might be preserved. The Government on the contrary, disregards the effect of everything which preceded the issue or distribution of the stock of the pipe line companies, and attempts to give the transaction the aspect of one which involves nothing except the distribution of property to stockholders.

So complete is the Government's absorption in technicalities of form that it apparently misunderstands our argument that as a result of the transaction nothing was freed from corporate control and business risks and transferred to the absolute ownership of the stockhold-

er. The Government says, at page 16 of its brief, that our argument amounts to a contention that whenever a stockholder receives as a dividend shares of stock in another corporation he does not receive income simply because the shares of stock are subject to the corporate control of the company which issues them. We make no such contention. When we argue that nothing was separated from corporate control and business risks we refer of course to the pipe line properties, and not to the stock of the pipe line companies. It is difficult to understand how our argument could have been misunderstood, because in making it we clearly stated, as, for example, at page 55 of our main brief, that we were referring to the pipe line properties.

Apparently we are talking about one thing—the substance, and the Government is talking about another thing—the form. This Court has said that “regard must be had to * * substance and not to form.”

The viewpoint of the Government is illustrated by its concession at page 14 of its brief, that if the oil companies had held the stock of the pipe line companies the transaction would have been one with respect to which no tax could have been claimed, and its further concession that if thereafter a stock dividend capitalizing the surplus had been issued no tax would have been payable. If it had not been for the lack of power of The Prairie Oil & Gas Company to hold the stock of the pipe line company, and the possibility of technical objection by State and Federal Commissions if The Ohio Oil Com-

pany did so, the stock of the pipe line companies might very well have been held by the oil companies, and everything which the oil companies sought to and did accomplish by the transaction involved in the case at bar would have been accomplished. It is clear, therefore, that the Government does not claim that there was anything in the substance of what the oil companies accomplished which properly renders their stockholders taxable, and that it is only on account of the necessary technicalities and formalities of the particular transaction that a tax is sought to be imposed.

II.

The Government's assertion that the oil companies characterized the issue or distribution of the stock of the pipe line companies as "dividends" is unwarranted by the facts in the record.

It appears in the record that the practice of both of the oil companies was to charge to dividend account the amount of all dividends paid, and that in connection with the particular transaction no entry was made in the dividend account of either of the oil companies. (No. 535, Rec. Fols. 21, 28; No. 536, Rec. Fols. 11, 18.) In the case of The Prairie Oil & Gas Company the transfer of the pipe line properties necessitated that there be charged off through profit and loss account the sum of \$27,000,000. The Government says, at page 8 of its brief,

that this sum represented the value of the stock of the pipe line companies. It did not. The stock of the pipe line companies had never been entered as an asset of The Prairie Oil & Gas Company. It represented the book value of the pipe line properties. In the case of The Ohio Oil Company, the stock of the pipe line companies was taken up on its books. It was, therefore, necessary to carry it out through profit and loss account. The entry was there designated "dividend." It was obviously so called simply because it was desired to give some explanation of the entry in the profit and loss account, and that seemed a convenient way to do it. If it had been regarded by the company as a dividend it would of course have been carried through the dividend account.

The only importance which we attach to the fact that the oil companies did *not* characterize the issue or distribution of the stock of the pipe line companies as "dividends" is that it completely disposes of the argument made at page 20 of the Government's brief, that whenever property is distributed as a dividend it must constitute a distribution of surplus. The fact being that the oil companies did not characterize the issue or distribution of the stock of the pipe line companies as dividends, the character of the property distributed determines whether it is capital or surplus, and since on the Government's own theory the property distributed was the stock of the pipe line companies received upon the transfer of the pipe line properties, the distribution was on principle and under the authorities a distribution of capital—

not because it was stock but because it was the proceeds of the disposition of business plant constituting an integral part of the enterprise.

III.

The Government disregards entirely the fundamental distinction between the distribution to stockholders of mere liquid treasury assets on the one hand, and, on the other hand, the proceeds of the disposition of business plant constituting an integral part of the enterprise.

The Government asks, at page 21 of its brief, whether there is anything more liquid than a share of stock that can be sold on ten minutes' notice to a stockbroker. There is at least one thing which is more liquid, and that is cash, and it was cash which was distributed to the stockholders in the life tenant and remainderman cases referred to under Point Four in our main brief. The real inquiry is not the nature of the particular property transferred, but how it was acquired, and the authorities are unanimous that when an integral part of a business enterprise is sold and the proceeds, whether cash or stock or anything else of value, are distributed to the stockholder, that distribution is not a distribution of surplus or of income, but is a refundment to the stockholder of all or a part of his capital investment.

The Government states that the life tenant and re-

mainderman cases are not analogous to the case at bar. This Court said, in *Towne vs. Eisner*, 245 U. S. 418, at page 426:

“Notwithstanding the thoughtful discussion that the case received below we cannot doubt that the dividend was capital as well for the purposes of the Income Tax Law as for distribution between tenant for life and remainderman. What was said by this Court upon the latter question is equally true for the former.”

IV.

The Government exaggerates the significance of a stock certificate itself as distinguished from what it represents.

Throughout the briefs of the Government in the *Phellis* case and in the case at bar there runs the conception that so long as a stockholder retains his stock certificates and the corporation retains its franchise, nothing else matters. This misconception is the reason for the emphasis which the Government places upon the retention by the stockholders of the oil companies of their stock in those companies. Thus at page 12 of its brief in the case at bar, the Government, in an effort to persuade this Court that the case at bar is its stronger case, admits that if in the *Phellis* case the du Pont Powder Company had proceeded to liquidate its affairs and dissolve as a corporation “a more serious question would have arisen,” and then states “upon that ques-

tion I need not express any opinion, for there was no liquidation or impairment of capital." Apparently the Government's theory is that there can be no liquidating dividend in the sense that what the stockholder receives is capital, not income, unless the capital stock is reduced. When the question is whether the result of a distribution to stockholders is the receipt of income or a refundment of capital, the fact that there has been no retirement of stock is not conclusive that the distribution constitutes a receipt of income. The stockholder's capital interest is liquidated just as completely if all of the assets of the corporation are transferred to the stockholders although he retains his stock (which, of course, has become worthless because the corporation owns nothing), as if he surrenders his stock for retirement. The question whether the stockholder has received income on his capital investment, or a refundment of that capital investment, cannot depend upon the technicality whether he remains the owner of a worthless stock certificate or surrenders it for cancellation.

Because the stockholders of the oil companies continued to hold all of their certificates of stock, the Government would have us believe that the fact that the oil companies no longer owned the pipe line properties which had theretofore constituted in the one case a quarter, and in the other case a half, of their income-producing assets, is of no significance whatever. Perhaps it is not, for purposes of form and technicality; but for purposes of truth and substance it is a matter of the first importance.

V.

The Government misconceives the entire issue in assuming that it need only establish that the pipe line companies were separate and distinct corporations and that the stock of those companies was received by the stockholders of the oil companies.

The Government's chief contention appears to be that, since the stock received by the stockholders of the oil companies was the stock of other corporations, the transaction was not a typical stock dividend, and it takes for granted that that is all that it is required to show in order to establish its case. It assumes that in the *Towne* and *Macomber* cases nothing was decided—no principle laid down—no precedent established—except that the capitalization of surplus by the issue of a stock dividend does not constitute the receipt of income by the stockholders.

In the *Towne* and *Macomber* cases this Court did something more than establish the applicability of certain fundamental principles of corporation law to the precise case of the issue of a stock dividend—it established the applicability of those principles to the entire system of income taxation. The principles to which we refer are the principles that (1) the interest of a stockholder is a capital interest with respect to the surplus as well as the capital of a corporation, and (2) that earnings of a corporation remain corporate property, unless and until distributed to the stockholders.

In *People ex rel Union Trust Co. v. Coleman*, 126 N. Y., 433, it was held that in determining the value of the "capital stock" of a corporation for purposes of taxation it was not proper to take the aggregate market value of all of its outstanding shares of stock. The New York Court of Appeals said, at page 437:

"The capital stock of a company is one thing; that of the shareholders is another and a different thing. That of the company is simply its capital, existing in money or property, or both; while that of the shareholders is representative, not merely of that existing and tangible capital, but also of surplus, of dividend earning power, of franchise and the good will of an established and prosperous business * * * So that the property of every company may consist of three separate and distinct things, which are its capital stock, its surplus, its franchise; but these three things, several in the ownership of the company, are united in the ownership of the shareholders. The share stock covers, embraces, represents all three in their totality, for it is a business photograph of all the corporate possessions and possibilities."

In *Gibbons v. Mahon*, 136 U. S. 549, which involved the question of the rights of life tenant and remainderman in stock issued as a stock dividend, Mr. Justice Gray, speaking for this Court, said, at page 558:

"Money earned by a corporation remains the property of the corporation, and does not become the property of the stockholders, unless and un-

til it is distributed among them by the corporation. The corporation may treat it and deal with it either as profits of its business, or as an addition to its capital. Acting in good faith and for the best interests of all concerned, the corporation may distribute its earnings at once to the stockholders as income; or it may reserve part of the earnings of a prosperous year to make up for a possible lack of profits in future years; or it may retain portions of its earnings and allow them to accumulate, and then invest them in its own works and plant, so as to secure and increase the permanent value of its property."

In *Eisner v. Macomber*, 252 U. S. 189, this Court said, at page 208:

"Certainly the interest of the stockholder is a capital interest, and his certificates of stock are but the evidence of it. * * * Short of liquidation, or until dividend declared, he has no right to withdraw any part of either capital or profits from the common enterprise; on the contrary, his interest pertains not to any part, divisible or indivisible, but to the entire assets, business, and affairs of the company."

After referring to the bookkeeping entries incidental to the retention of profits by the corporation, this Court said, at page 209:

"None of these, however, gives to the stockholders as a body, much less to any one of them, either a claim against the going concern for any particular sum of money, or a right to any par-

ticular portion of the assets or any share in them unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose."

Again, at page 219, it said that "what is called the stockholder's share in the accumulated profits of the company is capital, not income," for the reason that "a stockholder has no individual share in accumulated profits, nor in any particular part of the assets of the corporation, prior to dividend declared."

The result of the application of these principles in the *Towne* and *Macomber* cases to the system of income taxation was to establish the rule that the stockholder must pay a tax when he actually receives for his own use and benefit a distribution of corporate earnings, or when he realizes a gain or profit upon a sale of his stock, but that until then he is not to be taxed upon any metaphysical theory that the accumulation of earnings by the corporation constitutes income to the stockholder.

The primary reason that the principles of corporation law referred to were held by this Court to be applicable to questions of income taxation is that those are the very principles upon which was based the system of taxation established by the Income Tax Law of 1913 and continued in effect by the subsequent statutes. Under that system the corporation is taxed on its earnings. The stockholder is not taxed on the earnings of the corporation but only on such portion thereof as is dis-

tributed to him in the form of dividends. The system recognizes the propriety of the retention of earnings by the corporation and their investment in increased works and plant, subject to the limitation contained in Section A, subdivision 2, of the Act of 1913, that earnings fraudulently so retained for the purpose of exempting the stockholder from taxation shall be treated as part of the income of the stockholder.

This system is economically sound. The taxation of corporate earnings is logical, simple and convenient. The payment of the tax by the corporation properly secures an exemption from the normal tax of that portion of the earnings subsequently distributed to the stockholder, but the principle of sliding scale rates in the taxation of individual incomes requires that the stockholder pay the surtax thereon, and, of course, the stockholder's gain or profit on the sale of his stock is subject to both the normal tax and the surtax. Corporate earnings, other than those fraudulently retained in the business, should not be subjected to further taxation. The retention of those earnings stimulates industry and renders possible greater corporate earnings, which will in turn be taxed in the hands of the corporation, and larger dividends, which will be taxed when received by the stockholder.

The further principle of income taxation, that both corporate earnings and individual income shall be taxed as of the year of realization, has been of the utmost importance in recent years because the rates for almost every year have varied according to the fiscal needs of the Government.

Bearing in mind these fundamental principles of taxation recognized by Congress and by this Court, and disregarding technicalities, fiction and metaphysics, which of the three policies with respect to the treatment of earnings mentioned in *Gibbons v. Mahon* did the oil companies adopt? Did they (1) distribute earnings at once to the stockholders as income, or (2) reserve earnings of one year for possible distribution in future years, or (3) invest earnings in works and plant so as to secure and increase the permanent value of the properties? Clearly enough, the oil companies adopted the third policy and invested earnings in works and plant—treated them as an addition to capital.

What was there done to effect a change in that policy, to take the earnings out of works and plant—out of the business—and to give them to the stockholders? The Government says it was the transfer of the pipe line properties and the issue or distribution of the stock of the pipe line companies to the stockholders of the oil companies. Our reply is that that transaction did nothing of the sort, that its only effect was that the earnings remained in works and plant owned by, and in businesses conducted by, two separate corporations instead of by a single corporation, and that the capital interest of the stockholder was converted from a capital interest in a single corporation owning all of the works and plant and conducting both of the businesses, into a capital interest in two corporations, each of which owned a part of the works and plant and conducted one of the businesses.

What really happened was that the oil companies during the years preceding and including 1915, consistently pursued the policy of retaining a considerable portion of their earnings for purposes of increasing their works and plants. There was nothing in that which was in any way a fraud upon the tax system or an evasion of taxation. In 1915 it became necessary that a part of the works and plants should be transferred to newly organized corporations. This transfer was made with no intent to escape or decrease taxation. The earnings which had been retained in the business remained in the business.

The point which the the Government emphasizes is that the stockholders retained their original stock and received new stock. If the transfer of the properties had not been necessary, and the surplus had been capitalized by the issue of a stock dividend, the stockholders would equally have received new stock, and it is recognized that that would not have constituted income or subjected them to taxation. The Government admits that if the stock of the pipe line companies had been held by the oil companies the transaction would not have been taxable. It is clear, therefore, that there has been no subterfuge. The corporations continued in business, using as capital the former earnings retained in the business to produce increased earnings, upon which excess profits taxes were paid, and paying dividends to the stockholders, upon which they in turn paid surtaxes at the highest rates in history.

Shall it be said that the stockholder received as income

in 1915 the surplus which in all common sense obviously remained in the business to produce the earnings upon which excess profits taxes were payable, and dividends upon which war taxes were imposed? Shall we lose sight of the fact that the position of the stockholder remained substantially unaltered by reason of the transfer of the pipe line properties made in 1915?

The correct solution of the problem is that the only effect of the transfer of the pipe line properties and the issue or distribution of the stock of the pipe line companies was to alter the form of the capital interest of each stockholder of the oil companies, that our system of taxation leaves such a transaction untaxed, and that its entire purpose and design is accomplished in taxing the oil companies and the pipe line companies upon their earnings, and the stockholder upon his true dividends and any gain or profit realized when he sells his stock.

In the case at bar we find that the Bureau of Internal Revenue is endeavoring, upon a basis of the purest fiction and artificiality, to tax stockholders upon corporate earnings which have not in fact and in substance been distributed to them, but which have, on the contrary, been retained in the business. The Bureau of Internal Revenue cannot deny that as a practical matter the earnings were retained in the business, but it asserts that a tax is due from the stockholders because a part of the works and plant of that business was transferred to a newly organized corporation. It needs no argument to demonstrate that, as a matter of principle and the proper enforcement of our tax laws, that is no basis for such an assertion.

The outstanding feature of the decisions in the *Towne* and *Macomber* cases is that they recognize the fundamental principles of our system of taxation, that the stockholder pays when he realizes his income and not before, and that when a corporation has kept its earnings in the business the fact that those earnings have been capitalized by the issue of additional stock will not be allowed to serve as an excuse for a departure from sound principles of the law of corporations and our system of taxation. Clearly, there was better excuse for the disregard of these principles in a case in which the corporate act consisted of the capitalization of surplus transferred to capital account, than in a case in which the corporate act consists of the capitalization of works and plant, constituting a distinct and integral business, by the transfer thereof to a newly organized corporation.

In its attempt to establish that the *Towne* and *Macomber* cases have no bearing because in the case at bar new corporate entities were created, the Government overlooks entirely the fundamental consideration that a stockholder's interest in the surplus as well as the capital of the corporation is a capital interest, that it can cease to be such a capital interest only by virtue of some act of the corporation calculated to convert the surplus from corporate property dedicated to the business, into the individual property of the stockholder subject to his absolute use and disposition, and that in the case at bar every feature of the transaction compels the conclusion that the last thing which the oil companies desired or in-

tended was that any corporate assets, be they termed capital or surplus, should be taken out of the business and put into the hands of the stockholders.

GEORGE WELWOOD MURRAY,
HARRISON TWEED,
Counsel for Plaintiffs-in-Error.

MURRAY, PRENTICE & ALDRICH,
Attorneys for Plaintiffs-in-Error.

ROCKEFELLER *v.* UNITED STATES.

NEW YORK TRUST COMPANY ET AL., EXECUTORS OF HARKNESS, *v.* EDWARDS, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK.

ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

Nos. 535, 536. Argued October 11, 12, 1921.—Decided November 21, 1921.

1. Where the stockholders of a corporation, which is engaged in producing, buying and selling crude petroleum and in transporting it through its pipe lines, form a new corporation to which the pipe line property is conveyed by the old corporation and in consideration therefor and as part of the transaction all the capital stock of the new corporation, of par value equal to the valuation of the property so conveyed, is distributed among such stockholders *pro rata*, either by being issued to them directly, or by being first

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Argument for Plaintiffs in Error.

issued to the old corporation and then so distributed, and the old company possesses such a surplus that the transaction leaves its capital unimpaired and requires no reduction of its outstanding issues, the shares so received by the stockholders are a dividend within the meaning of the Income Tax Act of October 3, 1913, c. 16, 38 Stat. 166, and income within the meaning of the Sixteenth Amendment. P. 182. *United States v. Phellis*, ante, 156.

2. Such a distribution of shares, whatever its effect upon the aggregate interests of the stockholders, constitutes, in the case of each individual, a gain in the form of actual, exchangeable assets transferred to him from the old company for his separate use, in partial realization of his former indivisible and contingent interests in the corporate surplus—in substance and effect a dividend of profits by the corporation, and individual income of the shareholder. P. 183.

274 Fed. 952, affirmed.

ERROR to judgments of the District Court sustaining income tax assessments under the Income Tax Law of October 3, 1913, and the Sixteenth Amendment. In No. 535, the action was by the United States, to collect the tax, against the plaintiff in error Rockefeller. In No. 536, the plaintiffs in error, having paid the tax under protest, sued the collector to recover the amount with interest.

Mr. George Welwood Murray, with whom *Mr. Harrison Tweed* was on the briefs, for plaintiffs in error.

The fact is that the transaction was purely a capital transaction, the substance of which was merely an alteration in the form of the stockholder's capital interest—an exchange of one form of capital interest for another—from which no income was derived.

The rules and principles established by this court and applied by it in the *Towne* and *Macomber Cases* prohibit a resort to metaphysics to establish the receipt of income in connection with a transaction which from the point of view of the corporation was a necessary separation of its

two lines of business, and from the point of view of the stockholder was a mere change in the form of his capital investment.

Regard must be had to the substance and entirety of the transaction.

The meaning to be attached to the word "income" is not that ascribed to it by dictionaries or economists, but is, on the contrary, the meaning in which it is commonly used and understood.

There are three essential elements of income: (a) gain; (b) separated from the capital, and (c) realized by the recipient.

In the case of a stockholder, income is not realized unless and until something has been freed from corporate control and business risks and transferred to the absolute ownership of the stockholder.

The *Towne Case* illustrates the application of the foregoing rules and principles to facts very similar to the facts in the case at bar and is conclusive that the stock of the pipe line companies did not constitute income within the meaning of the Income Tax Law of 1913.

The opinion of the court in the *Macomber Case* is simply a more thorough analysis of the facts and principles which controlled the decision in the *Towne Case*, and an extension of that decision to cover the construction of the Sixteenth Amendment.

The *Macomber Case* is conclusive that the stock of the pipe line companies did not constitute income within the meaning of the Sixteenth Amendment.

Any dissent in the *Macomber Case* was based upon considerations which have no application in the case at bar.

The stock of the pipe line companies did not become a part of the assets of the oil companies.

There is a fundamental distinction between the distribution to stockholders of liquid treasury assets on the one hand, and, on the other hand, the proceeds of the disposi-

tion of business plant constituting an integral part of the enterprise.

No part of the cause of action of plaintiffs in error in No. 536 is barred by the provisions of §§ 3226 and 3227, Rev. Stats.

Mr. Solicitor General Beck, with whom *Mr. Carl A. Mapes*, *Mr. Newton K. Fox* and *Mr. Andrew J. Aldridge* were on the brief, for defendants in error.

If there be any difference in principle between the facts of these two cases and those in the *Phellis Case*, *ante* 156, the facts now under consideration by the court are even stronger for the Government than in the *Phellis Case*. In that case the Du Pont Powder Company sold all its assets to the new corporation; and, had the former then proceeded to liquidate its affairs and dissolve as a corporation, a more serious question would have arisen, whether upon final liquidation that portion of the assets which were distributed—which undoubtedly represented accumulated earnings from operations—would or would not be taxable.

In the two present cases each oil company only sold a part of its assets (the part being far less than its surplus), and then vendor and vendee corporations continued actively in their respective businesses, the one as a producer, and the other as a transporter, of oil.

The argument that was made in the *Phellis Case*, that this court must regard the New Jersey and Delaware corporations as substantially one corporation on the theory of practical identity of function and purpose, can not be applied to the two instant cases, for the very purpose of the transactions in these cases was to destroy any possible identity by dividing between the two corporations two separate and distinct functions in the oil industry. Thenceforth, the oil companies had no further concern with transportation and the pipe line companies had no further connection with production.

MR. JUSTICE PITNEY delivered the opinion of the court.

These two cases were argued together, turn upon like facts, and may be disposed of in a single opinion. They involve the legality of certain income taxes assessed against the plaintiff in error in the one case, and against the testator of plaintiffs in error in the other, under the Income Tax provisions of the Act of October 3, 1913, c. 16, 38 Stat. 114, 166-167, by reason of certain distributions of corporate stocks received by the respective taxpayers under the following circumstances. In and prior to the year 1914, the Prairie Oil & Gas Company, a corporation of the State of Kansas, was engaged in producing, purchasing and selling crude petroleum, and transporting it through pipe lines owned by the company in the States of Kansas and Oklahoma, and elsewhere. At the same time the Ohio Oil Company, a corporation of the State of Ohio, was engaged in producing and manufacturing petroleum and mineral oil and transporting the same through pipe lines owned by it in the States of Ohio, Indiana, Illinois and Pennsylvania. In the month of June, 1914, it was judicially determined by this court (*The Pipe Line Cases*, 234 U. S. 548), that with respect to the transportation business these companies were common carriers in interstate commerce, subject to the Act to Regulate Commerce as amended by Act of June 29, 1906, c. 3591, 34 Stat. 584, and as such subject to the supervision of the Interstate Commerce Commission. By Act of September 26, 1914, c. 311, 38 Stat. 717, the remainder of their business became subject to the supervision of the Federal Trade Commission. In order to avoid a probable conflict of federal authority in case the combined business of production and transportation should continue to be carried on as theretofore, it was in each case, upon advice of counsel, determined that the pipe line property should be owned and operated by a separate corporation. In the

case of the Ohio company an added reason for segregation lay in the fact that by a section of the Ohio General Code its entire gross receipts, including those derived from business other than transportation, were subject to an annual assessment of 4% chargeable against the gross receipts of companies engaged in the transportation business. For these reasons, the stockholders of the Prairie Oil & Gas Company caused a corporation to be organized under the laws of the State of Kansas, by the name of the Prairie Pipe Line Company, to which all the pipe line property of the Prairie Oil & Gas Company was transferred in consideration of the issue and delivery of the entire capital stock of the new company, to be distributed *pro rata* to the stockholders of the Prairie Oil & Gas Company. And similarly, the stockholders of the Ohio Oil Company caused a corporation to be formed under the laws of that State, by the name of the Illinois Pipe Line Company, to which all the pipe line property of the Ohio Oil Company was transferred in consideration of the issue to it of the entire capital stock of the new company, which was to be distributed at once by the old company to its stockholders *pro rata*. These arrangements were carried out in like manner in both cases, except that in the case of the Kansas companies the stock of the pipe line company was issued directly to the stockholders of the oil company, whereas in the case of the Ohio companies the pipe line company issued its stock to the oil company, but in the same resolution by which the contract was made, an immediate distribution of the new stock among the oil company's stockholders was provided for, and in fact it was carried out. The aggregate valuation of the Prairie pipe lines was \$27,000,000, that of the Ohio pipe lines \$20,000,000, and the total capitalization of the respective pipe line companies equaled these amounts.

In each case, the oil company had a surplus in excess of the stated value of its pipe lines and of the par value of

the total stock of the corresponding pipe line company; so that the transfer of the pipe lines and the distribution of the stock received for them left the capital of the respective oil companies unimpaired and required no reduction in their outstanding issues.

Messrs. Rockefeller and Harkness respectively were holders of large amounts of the stock of both the Prairie and the Ohio oil companies and in the distributions each received an amount of stock in each of the pipe line companies proportionate to his holdings in the oil companies. This occurred in the year 1915. Neither Mr. Rockefeller nor Mr. Harkness nor the latter's executors sold any of the stock in the pipe line companies.

Income tax assessments for the year 1915 were imposed upon Messrs. Rockefeller and Harkness, based upon the value of the stocks thus received as dividends; and these assessments are in question in the present suits, both of which were brought in the District Court of the United States for the Southern District of New York: one by the United States against Mr. Rockefeller, the other by the executors of Mr. Harkness against the Collector. In each case the facts were specially pleaded so as to present the question whether the distribution of the stocks of the pipe line companies among the stockholders of the oil companies constituted, under the circumstances, dividends within the meaning of the Act of 1913, and income within the meaning of the Sixteenth Amendment. In each case a final judgment was rendered sustaining the assessment, and the judgments are brought here by direct writs of error under § 238, Judicial Code, because of the constitutional question.

Under the facts as recited we deem it to be too plain for dispute that in both cases the new pipe line company shares were in substance and effect distributed by the oil company to its stockholders; as much so in the case of the Kansas company where the new stock went directly

from the pipe line company to the stockholders of the oil company, as in the case of the Ohio company where the new stock went from the pipe line company to the oil company and by it was transferred to its stockholders. Looking to the substance of things the difference is unessential. In each case the consideration moved from the oil company in its corporate capacity, the new company's stock issued in exchange for it was distributed among the oil company's stockholders in their individual capacity, and was a substantial fruit of their ownership of stock in the oil company, in effect a dividend out of the accumulated surplus.

The facts are in all essentials indistinguishable from those presented in *United States v. Phellis*, decided this day, *ante*, 156. In these cases as in that, regarding the general effect of the entire transactions resulting from the combined action of the mass of stockholders, there was apparently little but a reorganization and financial readjustment of the affairs of the companies concerned, here a subdivision of companies, without immediate effect upon the personnel of the stockholders, or much difference in the aggregate corporate activities or properties. As in the *Phellis Case*, the adoption of the new arrangement did not of itself produce any increase of wealth to the stockholders, since whatever was gained by each in the value of his new pipe line stock was at the same moment withdrawn through a corresponding diminution of the value of his oil stock. Nevertheless the new stock represented assets of the oil companies standing in the place of the pipe line properties that before had constituted portions of their surplus assets, and it was capable of division among stockholders as the pipe line properties were not. The distribution, whatever its effect upon the aggregate interests of the mass of stockholders, constituted in the case of each individual a gain in the form of actual exchangeable assets transferred to him from the oil com-

pany for his separate use in partial realization of his former indivisible and contingent interest in the corporate surplus. It was in substance and effect, not merely in form, a dividend of profits by the corporation, and individual income to the stockholder.

The opinion just delivered in *United States v. Phellis*, sufficiently indicates the grounds of our conclusion that the judgment in each of the present cases must be

Affirmed.

MR. JUSTICE CLARKE took no part in the consideration or decision of these cases.

MR. JUSTICE VAN DEVANTER and MR. JUSTICE McREYNOLDS dissent.